This rule was filed as SIC Rule 89-4.

TITLE 2 PUBLIC FINANCE
CHAPTER 60 INVESTMENT AND DEPOSIT OF PUBLIC FUNDS
TITLE 27 INVESTMENT POLICY AND GUIDELINES ON PARTICIPATION LOANS SECTION 7-27-5.1 MARKET RATE INVESTMENTS

2.60.27.1 ISSUING AGENCY: State Investment Council.
[Recompiled 10/01/01]

2.60.27.2 SCOPE: [RESERVED]
[Recompiled 10/01/01]

2.60.27.3 STATUTORY AUTHORITY: Pursuant to Section 7-27-5.1A NMSA 1978 Subparagraph 10, the severance tax permanent fund may be invested in participation interests in New Mexico real property-related business loans if the proceeds of such loans will be or are being used by the borrower to either commence or expand operations in New Mexico. The loans purchased may be in amounts from five hundred thousand to two million dollars. The minimum loan amount may be met by the packaging of up to five separate loans which otherwise meet the requirements of the program.
[Recompiled 10/01/01]

2.60.27.4 DURATION: [Permanent]
[Recompiled 10/01/01]

2.60.27.5 EFFECTIVE DATE: [Filed January 17, 1990]
[Recompiled 10/01/01]

2.60.27.6 OBJECTIVE: [RESERVED]
[Recompiled 10/01/01]

2.60.27.7 DEFINITIONS: [RESERVED]
[Recompiled 10/01/01]

2.60.27.8 POLICY:

A. It is the state investment council's objective in making resources available for the purchase of participations in loans to achieve a yield consistent with the safety and soundness of such investments. With this in mind, the state investment officer may purchase from eligible New Mexico financial institutions a participation interest of up to eighty percent in any loan secured by a first mortgage or a deed of trust on real property located in New Mexico of an eligible business entity, or its subsidiary, which is operating or shall use the loan proceeds to commence operations within New Mexico, plus any other guarantees or collateral that may be judged by the eligible institution or the state investment officer to be prudent. Real property is defined as "land and attached buildings, but excludes all interests which may be secured by a security interest under Article 9 of the Uniform Commercial Code, and mineral resource values".

B. In accordance with the provisions of the statute, loan proceeds shall be used exclusively for the purpose of expanding or establishing businesses in New Mexico. The use of loan proceeds may include the refinancing of a business' existing loans outstanding only if the loan is for expansion purposes. However, if a portion of the loan proceeds are used to repay an existing loan and payment of principal and interest on the loan is not paid within ninety days from the due date, the originating institution shall buy back the state's participation interest in the loan.

C. Loan origination fees, servicing fees and any other fees to be charged the borrower shall be reviewed by the state investment officer.

D. The amount invested in New Mexico real property related business loans shall not exceed ten percent of the severance tax permanent fund, and shall be included in any minimum amount of severance tax permanent fund investments required to be placed in New Mexico certificates of deposit.

E. Loans which are being offered to the state investment officer for consideration for participation are subject to the following requirements:

(1) Eligible business entities shall not include public utilities, financial institutions, shopping centers, apartment buildings, or other such passive investments. The decision as to whether a business investment is considered a passive investment shall be determined by the state investment officer.

(2) The minimum loan amount shall be five hundred thousand dollars ($500,000.00) and may be met by a single institution packaging up to five separate loans to satisfy the requirements of this Subsection. The maximum loan amount shall be two million dollars ($2,000,000.00).

(3) Loan maturities shall not be less than five years or more than fifteen years. The loan shall be fully amortized over the maturity period and may not include any balloon payments.

(4) The maximum loan-to-value ratio shall be seventy-five percent based on a current MAI appraisal of the real property, or an equivalent appraisal, as approved by the state investment officer. The appraisal shall be completed no more than six months prior to the loan origination date.

(5) Interest rates shall be fixed for five years and shall be adjusted at every fifth anniversary. The yield on the states' participation interest shall never be less than the greater of the then prevailing yield on United States treasury securities of five year maturity, plus two and one-half percent or the yield received by the lending institution, calculated exclusive of servicing fees.

(6) If the payment of principal or interest is not made within ninety days from the due date, and before payment has not been made for one hundred and eighty days from the due date, the originating institution shall buy back the state's participation interest in the loan, substitute another qualifying loan, or begin foreclosure proceedings unless the payment is extended pursuant to an agreement between the originating institution and the state investment officer. If foreclosure proceedings are commenced, the state and the originating institution shall share in proportion to their participation interest in the legal and other foreclosure expenses. Any investment loss incurred as a result of foreclosure sale shall also be shared proportionately. Under no circumstance shall the state be liable for more than the amount of its investment in the participation.

(7) The loan agreement between the borrower and the originating institution must include a due on sale clause if the business is sold.

(8) The state investment officer will consider the following industries to insure diversification across the state in the loan participation program. A twenty-five percent maximum may be invested from the total amount allocated from the severance tax permanent fund in any one of the following classes of industries:

(a) agriculture, forestry, fishing and related processing;
(b) mining;
(c) construction;
(d) manufacturing;
(e) transportation;
(f) wholesale trade;
(g) retail trade;
(h) services.

(9) In addition, funds available to the state investment officer for purchase of participations in loans secured by a first mortgage or deed of trust shall be allocated considering but not limited to the following:

(a) the financial condition of the financial institution offering to sell loan participations; such condition shall be based on the quarterly evaluation of financial condition, as determined under the state investment council's certificate of deposit collateral policies, with preference given to institutions evaluated as class A and class B. Class D institutions will not receive funds.

(b) The amount of total loan participations purchased from a single institution shall not exceed ten percent of the maximum total funds authorized for investment in loan participations.

(c) The percentage a county or geographic area's population is to the total population of the state as determined by the most recent decennial census or official population estimates, prepared by the U.S. census bureau, department of commerce.

(10) Before the state investment officer purchases a participation in a loan or package of loans all documents will be subject to review and approval by the office of the attorney general. The state investment officer may employ the services of a private attorney to review and prepare documents on the investment office's behalf if he finds it to be necessary. The cost of such attorney will be paid for by the institution selling the participation and may be passed on to the borrower.

[Recompiled 10/01/01]

2.60.27.9 UNDERWRITING GUIDELINES ON LOAN PARTICIPATIONS: The selling institution shall provide copies of the necessary documentation, so that the state investment officer can perform an independent analysis of the credit quality of the obligation to be purchased, document the obligation, thoroughly analyze collateral, and maintain complete and current credit information on the borrower throughout the term of the loan. The decision of the state investment officer as to whether or not a loan participation should be purchased shall be final.
[Recompiled 10/01/01]

2.60.27.10 LOAN DOCUMENTATION REQUIRED PRIOR TO COMMITMENT:

A. Formal loan request or loan application, stating purpose, description of collateral offered, terms and conditions.

B. Copies of financial statements, income statements and balance sheets covering the latest 3 fiscal years; If not available audited proforma statements may be substituted for all but the most recent fiscal year.

C. A current credit bureau report on borrower(s), plus a credit history on current obligations for all borrowings outstanding, including accrual status, and the status of principal and interest payments.

D. Appraisal on the real estate by an MAI or other qualified, approved appraisers. Appraisal should include an evaluation of other comparable properties.

E. Copies of loan agreements that have been negotiated between the selling institution and the borrower.

F. Liquidity ratios, and other ratios if available from selling institutions, which indicate that the business will be able to meet maturing and current obligations. The preferred ratios would be quick ratios and current ratios.

G. Cash flow projections indicating the borrower has adequate revenues to satisfactorily operate the business and to service the loan.

[Recompiled 10/01/01]

2.60.27.11 FINAL DOCUMENTS BEFORE CLOSING:

A. Commitment by the state investment council stating all terms, conditions, final required documents, servicing fees and period of commitment.

B. Original participation agreement signed by purchaser and seller on the standard form approved by the Attorney General.

C. Certified copy of the original executed note and mortgage filed within the county where property is located.

D. Title insurance policy showing the loan to be first in priority upon the mortgaged property with the exception of items normally excluded from the scope of such policies.

E. Evidence of fire and hazard insurance coverage on the mortgaged premises, in an amount equal to the lesser of the loan balance or the insurable value on the improvements, with a loss payable clause in favor of the originating institution, plus flood insurance, where the premises are located in a flood hazard area.

F. Survey by a registered land surveyor verifying that the property is actually located where it is proported to be, and that the improvements do not encroach on adjoining property.

G. Corporate resolution designating an individual to sign for the corporation authorized by its' board of directors.

H. Quarterly financial statements, income statements and balance sheets for the latest twelve month fiscal period preceding the loan date and an annual financial statement for the most recent fiscal year. A certification from the originating financial institution that they have reviewed the financial statements, income statements and balance sheet and that to the best of their knowledge the statements are an accurate representation of the borrower's financial condition.

I. Copies of documentation showing compliance with applicable special State and Federal laws or regulations governing the borrower's business.

J. Continuing guarantees on closely held corporations to prevent transfer of assets from the corporation to avoid debt repayment. The need for personal guarantees shall be determined upon the recommendation of the selling institution consistent with their standard loan requirements.

[Recompiled 10/01/01]

2.60.27.12 GENERAL DEFINITIONS, INTERPRETATIONS AND LOAN CHECKLIST:

A. APPRAISALS: An objective appraisal is necessary to document the value of the collateral. Care is required to be sure the appraisal is objective, and reasonably reflects true market values.

B. TITLE POLICY: Title companies' primary business is insuring that security interests have been correctly perfected and that there exists no prior ownership interests. The title company guarantees that there will be no losses due to prior claims on the property. The exception clause to the property title should be read carefully. A title company may issue what appears to be a perfectly good title policy, but if it contains many exceptions in reality the title is not insured at all.

C. SECURITY AGREEMENTS: A security agreement is a legal document that outlines the secured party's right to non-real property not in the physical possession of the secured party. The security agreement must be used with at least one other document to perfect a collateral position. Usually the other document is a financing statement.

D. FINANCING STATEMENTS: A financing statement never stands alone. There must always be a security agreement backing the financing statement. The financing statement legally notifies all potential creditors of a secured party's position.

E. ASSIGNMENT OF A SECURED INTEREST: The secured party may assign all or part of their security interest in the collateral either before or after filing the financing statement. However, to be effective against persons other than the secured party, the assignment should be made a matter of record.

(1) If the assignment is made before filing, the financing statement may disclose the amount of the security interest in the collateral described in the statement by an indication in the statement of the name and address of the assignee, or by including the assignment itself, or a copy thereof, on the face or back of the statement.

(2) If the assignment occurs after filing, and it is made a matter of record by the filing, in the place where the original financing statement was filed, of a separate written statement of assignment signed by the secured party of record and the debtor, the file number and the date of filing of the financing statement, the name and address of the assignee, and a description of the collateral assigned must be included.

F. LOAN AGREEMENTS: The purpose of a loan agreement is to trigger defaults early in a deteriorating loan situation, so that the financial institution can accelerate the loan and gain control of the situation. No matter how tightly the loan agreement is written it does not improve the quality of the credit. It is tailored to fit the requirements of specific situations. The following are common protective provisions:

(1) maintenance of current working capital position;
(2) restrictions on borrowings;
(3) restrictions on dividends;
(4) restrictions on the sale or pledging of business assets;
(5) restrictions on merger or consolidation;
(6) restrictions on acquisitions of additional fixed assets or assuming of lease obligations;
(7) requirements to keep all taxes paid and in current status;
(8) requirements to maintain property and equipment in good repair;
(9) requirements for adequate insurance;
(10) requirements for furnishing financial statements and credit information;
(11) restrictions against retirement of capital stock;
(12) restrictions as to contingent liabilities;
(13) limitations on salary and bonuses, and advances to officers, employees and other companies.

[Recompiled 10/01/01]

2.60.27.13 RATIO ANALYSIS: Ratios are mainly indicators and as such should not be accepted nor used as absolute measurements. They are useful in pointing up areas of strength and weakness in statements. Many ratios are purely quantitative by nature and should not in any way be interpreted as measures of quality. A series of ratios over several periods of time is useful in pointing out trends in financing and operations. Ratios computed for any given company should be compared to industry ratios. If available, all significant variations should be investigated and explained. The following are basic ratios:

A. QUICK RATIO:

(1) Method of computation: The total of cash, short-term marketable securities and net receivables for the company is divided by the total of current liabilities.

(2) Result: The ratio measures short-term liquidity available to meet current debt.

(3) Principle: Also known as the acid test or liquidity ratio, it is of particular benefit to short-term creditors, as it expresses the extent to which cash and those assets most readily convertible into cash can meet the demands of current liabilities. Any value of less than 1 to 1 implies a reciprocal "dependency" on inventory or other current assets to liquidate short term debts.

B. CURRENT RATIO:

(1) Method of computation: The total of current assets for the company is divided by the total of current liabilities.

(2) Result: The ratio is one measure of the ability of the company to meet its current debt.

(3) Principle: In comparing an individual company to the industry, a higher current ratio indicates that more current assets are free from debt claims of creditors and prompter payment can be expected.

C. FIXED/WORTH:

(1) Method of computation: The net fixed assets (plant and equipment less reserve for depreciation) for the company is divided by the tangible net worth.

(2) Result: The ratio expresses the proportion between investment in capital (fixed) assets and the owner's capital.

(3) Principle: The higher the ratio, the less owner's capital is available for working capital. The lower this ratio, the more liquid is the net worth and the more effective the owner's capital is as a liquidating protection to creditors. The presence of substantial leased fixed-assets, off the balance sheet, may deceptively lower the ratio.

D. DEBT/WORTH:

(1) Method of computation: The total debt for the company is divided by the tangible net worth.

(2) Result: The ratio expresses the relationship between capital contributed by creditors to owner's capital-- "what is owed to what is owned".

(3) Principle: Total assets or resources represent the entire capital at the disposal of a company and consist of net worth or owner's capital, and creditor capital, that provided by those outside the business for temporary use. The proportion existing between debt and worth, or leverage, records the debt pressure. The lower the ratio, the easier the pressure and the greater the protection for creditors.

E. PROFITS BEFORE TAXES/WORTH:

(1) Method of computation: The amount of net profit before taxes is divided by the tangible net worth (previous year end).

(2) Result: The ratio expresses the relationship between the owner's share of operations before taxes for the year and the capital already contributed by the owners.

(3) Principle: Capital is usually invested in a company in the anticipation of a return on that investment in the form of a profit. This hope of a profit is the attraction for original and new capital. The higher the profit before taxes to worth, the greater is the probability of making appreciable addition to owners' capital after payment of dividends and taxes.

F. PROFITS BEFORE TAXES/TOTAL ASSETS:

(1) Methods of computation: The net profit before taxes of the company are divided by the total assets for the company.

(2) Result: The ratio expresses the owners' share of the year's operations before taxes related to the resources contributed by both owners and creditors.

(3) Principle: The relationship indicates the net profitability of the use of all resources of the business.

G. CASH PROFIT/CURRENT MATURITIES LONG TERM DEBT:

(1) Method of computation: The net profits plus depreciation and amortization are divided by the current portion of long term liabilities.

(2) Result: The ratio expresses the ability to retire term debt each year from cash generated by operations.

(3) Principle: Cash profit or "throw-off" is the primary source of regular repayment of long term debt. This ratio measures the coverage of such debt service. Often most if not all of the depreciation will be needed for fixed asset replacements and expenditures and similarly part of net profits may be committed to dividends. Hopefully, after all these payments, some portion of cash profit will be left available to enhance working capital. Although all cash profit is not available for debt service, the ratio is a valid measure of the optimum coverage and a useful calculation in all considerations of term lending.

H. UNSUBORDINATED DEBT/CAPITAL FUNDS:

(1) Method of computation: Total unsubordinated debt (all current plus senior long term debt) is divided by capital funds (tangible net worth plus long term subordinated debt).

(2) Result: The ratio expresses the proportion between senior creditors' capital and that provided by junior creditors and owners.

(3) Principle: The ratio records debt leverage in relation to the capital base, sometimes referred to as the borrowing base. This gives recognition in the borrowing base to that capital provided by creditors whose rights are subordinated to other creditors. The use of subordinated debt capital does not altogether remove a corresponding amount of debt pressure from owner's capital, but it does provide an extra cushion for senior creditors who can then view leverage from this ratio.

I. SALES/RECEIVABLES:

(1) Method of computation: The net annual sales for the company are divided by the total of trade accounts and bills receivables.

(2) Results: The ratio expresses the relationship of the volume of business to the outstanding receivables.

(3) Principle: A higher ratio, a higher turnover of receivables indicates a more rapid collection of sales during the period and a greater liquidity of the receivables.

J. DAY'S SALES:

(1) Method of computation: The sales/receivables is divided into 360 (the number of days in one year).

(2) Result: This figure expresses the average time in days that sales are uncollected.

(3) Principle: A comparison of this figure with the terms of sale for the industry will show the extent of control over credit and collections. The greater the number of days outstanding, the greater is the probability of delinquencies in accounts receivable.

K. COST OF SALES/INVENTORY:

(1) Method of computation: Cost of sales for the company is divided by the total of inventory.

(2) Result: The ratios expresses the proportion between cost of sales and inventory at the end of the fiscal period.

(3) Principle: The physical turnover measures merchandising capacity. The higher the ratio the greater is this capacity and the more probable the freshness, salability, and liquidating value of that inventory. Since profit has been eliminated, the cost of sales/inventory gives a more accurate measure of physical turnover than the sales/inventory. Other measures of physical turnover use average monthly inventory or an average of the inventories at the beginning and end of the period.

L. SALES/WORKING CAPITAL:

(1) Method of computation: The net annual sales for the company is divided by the net working capital or excess of total current assets over current liabilities.

(2) Result: The ratio expresses the turnover or annual activity of that portion of net capital not devoted to fixed or other non-current assets.

(3) Principle: Net working capital represents the basic support for those assets undergoing conversion cycles (as inventory-receivables-cash) during the selling year. Relating sales to working capital suggests the number of turns in working capital per annum. A low ratio may indicate unprofitable use of working capital while a very high ratio of ten signifies overtrading, a vulnerable condition for creditors.

M. SALES/NET WORTH:

(1) Method of computation: The net annual sales are divided by the tangible net worth.

(2) Result: The ratio reflects the activity of owners' capital during the year.

(3) Principle: Capital is invested in an enterprise in the hope of a substantial return. The probability of such a return is largely dependent upon a reasonable activity of the investment. This ratio is one measure of this activity. When the relation increases from year to year, it indicates that owner's capital is being used more frequently during the year. A very high ratio may indicate under capitalization (lack of sufficient ownership capital) or overtrading.

[Recompiled 10/01/01]

HISTORY OF 2.60.27 NMAC:

Pre-NMAC History: The material in this Part was derived from that previously filed with the State Records Center and Archives:

SIC Rule 89-4, Investment Policy and Guidelines on Participation Loans Section 7-25-5.1 Market Rate Investments, 1-17-90.

History of Repealed Material: [RESERVED]