S&P Global
Ratings

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Summary:

Alaska; Appropriations; General Obligation; Moral Obligation

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Credit Profile		
US$150.0 mil GO bnds ser 2016B due 08/01/2035		
Long Term Rating	AA+/Watch Neg	New
Alaska GO		
Unenhanced Rating	AA+(SPUR)/Watch Neg	On CreditWatch Negative
Alaska Mun Bnd Bank, Alaska		
Alaska		
Alaska Mun Bnd Bank GO		
Unenhanced Rating	AA(SPUR)/Watch Neg	On CreditWatch Negative

Rationale

S&P Global Ratings has placed its 'AA+' general obligation (GO), 'AA' appropriation, and 'A+' moral obligation ratings on Alaska's debt on CreditWatch with negative implications. We also assigned our 'AA+' GO rating to Alaska's $150 million in series 2016B GO bonds. The rating is on CreditWatch with negative implications.

The CreditWatch placement indicates that we may lower Alaska's credit rating if state policymakers defer adopting fiscal reforms to correct the state's structural budget deficit. We expect to resolve the CreditWatch placement following the conclusion of the legislature's special session and once the budget process for fiscal 2017 is complete and, in any event, within 90 days. Lawmakers are currently in a special session convened by Governor Bill Walker after the legislature adjourned its extended regular session in May without approving a budget for fiscal 2017. So far in the special session, the legislature has passed a $4.4 billion spending plan for fiscal 2017 and a bill to reduce the cost of the state's oil and gas tax credit program. In addition, the State Senate has approved legislation (Senate Bill, or SB, 128) permitting an annual transfer to the general fund from the permanent fund.

The annual transfer under SB 128--sized at 5.25% of a five-year rolling average of permanent fund market value--would produce approximately $2.4 billion in fiscal 2017. Of this, the legislation deducts $685 million to pay for the state's permanent fund dividend (PFD), which, at $1,000 per resident, would equal about half of the 2015 PFD. The remaining $1.7 billion would flow to the general fund and contribute to reducing the structural deficit. The legislation still requires approval by Alaska's House of Representatives, where its fate is uncertain. There are two main coalitions in the house skeptical of reducing the dividend. One group has sought corresponding reductions to the oil and gas tax credit program while the other would prefer deeper overall budget cuts. It's unclear whether either the legislatively approved budget or the tax credit reform bill goes far enough to garner sufficient support from these representatives to pass SB 128. As we understand it, the House may consider SB 128 during the week of June 13. If the legislature does not approve any fiscal reforms, it's possible the governor may decide to call another special session.

Transitioning the general fund away from its historically predominant reliance on oil-related revenue in favor of investment income has been a centerpiece of fiscal reforms proposed by the governor. It remains to be seen whether SB 128, if enacted, together with any other fiscal reforms the legislature might approve, would be sufficient to put Alaska's fiscal structure on a sustainable trajectory. Existing unrestricted revenues projected for fiscal 2017 fall short of the legislatively approved spending plan by $3.2 billion. The structural deficit is even larger--$3.8 billion, or 75% of expenditures--if another $642 million in spending that the legislature retroactively booked to fiscal 2016 is included. Enactment of SB 128 alone would shrink the deficit, but it wouldn't eliminate it. In order to fully close the structural fiscal gap, other measures--such as new income tax or more spending cuts--would also be necessary.

Alaska's comparatively large budget reserves have so far enabled it to self-finance its structural deficit and contribute to its still-strong creditworthiness, but we have not viewed the arrangement as sustainable. A Department of Revenue (DOR) projection shows that in the absence of changes to the state's fiscal structure, its budget reserves would continue to decline each year. The constitutional budget reserve (CBR) balance would fall to $3.21 billion at the end of fiscal 2017 from $6.9 billion in fiscal 2016 under the legislatively approved budget. There is also the state's $7.74 billion permanent fund earnings reserve (PFER) from which the legislature can appropriate with a majority vote. To date, the legislature has not tapped the PFER as a source of financing for the general fund. The PFER has instead traditionally served as the source of funding for the state's PFD program. Nevertheless, these reserves, when summed together, would total $10.9 billion--216% of expenditures--at the end of fiscal 2017, according to legislature's spending plan. While Alaska's budget reserves under a status quo scenario remain strong, they have come down significantly in just two years. At the end of fiscal 2015, total budget reserves equaled $17.6 billion, or 283% of expenditures. And without a change in the state's fiscal structure, the DOR projects that by fiscal 2020 its budget reserves could decline to $2.3 billion.

The GO bonds are backed by the state's full faith, credit, and resources. We understand that the state plans to use bond proceeds to pay for the cost of several transportation-related projects authorized in the 2012 state transportation bond act. Although the state is in the midst of grappling with large general fund operating deficits, we continue to view Alaska as having very strong credit quality. This reflects our view that the state benefits from several favorable features, including:

- Budget reserves that, despite not representing a permanent solution to the state's unrestricted general fund deficit problem, remain large, equal to 289% of annual appropriations (as of May 2016);
- The potential to resolve much of the general fund gap by overhauling the flow and customary treatment of various legally unrestricted state revenues; and
- Its moderate debt burden and closed defined-benefit retirement system with an adequate funding ratio (which improved in fiscal 2015 due to a large $3.0 billion asset infusion from the CBR).

Alaska considers broadening its general fund revenue sources amid oil price bust

Alaska's historical practice of utilizing its oil-related tax and royalty revenue to pay for a large majority of its general fund expenditures has resulted in its financial health tracking commodity markets. As recently as fiscal 2014, when oil prices topped $100 per barrel, Alaska generated nearly $4.8 billion in petroleum-related revenue, which accounted for 89% of its unrestricted general fund revenue. When the decline in oil prices that began in 2014 persisted throughout

2015, and then accelerated into early 2016, the state's fiscal gap ballooned. In its spring 2016 revenue forecast, the DOR based its fiscal 2017 revenue projections on an average price of $38.89 per barrel of Alaska North Slope crude, reflecting the global oil glut. Oil production has also been in long-term decline. The DOR forecasts 507,100 barrels per day of production in fiscal 2017, down 30% since 2007. Low prices and declining oil production result in $704.7 million of projected oil-related revenue now accounting for just 57% of the state's unrestricted revenue in fiscal 2017. Various other nonpetroleum-related fees, taxes, and interest income make up the balance of the state's unrestricted revenue. Insofar as oil prices have recently stabilized at a somewhat higher level than the DOR projection, actual revenues could outperform the forecast.

In addition to its unrestricted revenue, however, Alaska has another $3.1 billion in projected fiscal 2017 revenue subject to appropriation by the legislature. Much of this revenue ($2.5 billion) is from investment earnings generated by the state's $53 billion permanent fund. This revenue historically has flowed to the PFER, a portion of which has gone toward the PFD program. Therefore, repurposing this revenue for use by the general fund necessarily involves cutting the PFD, a difficult tradeoff from a policy perspective. SB 128 would do just this, however, by simultaneously establishing an annual transfer to the general fund from the PFER--based on a percentage of permanent fund market value--while reducing the PFD. For the first three years, the legislation diverts approximately $700 million to pay for the PFD, or about half the $1.4 billion cost of the program in fiscal 2016. Beginning in fiscal 2020, funding for the PFD would come from a combination of a 20% share of the annual transfer and 20% of state royalty revenue.

Related Criteria And Research

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: U.S. Public Finance Long-Term Municipal Pools, March 19, 2012
- USPF Criteria: Moral Obligation Bonds, June 27, 2006
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- USPF Criteria: Methodology: Rating Approach To Obligations With Multiple Revenue Streams, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of June 9, 2016)		
Alaska GO		
Long Term Rating	AA+/Watch Neg	On CreditWatch Negative
Alaska APPROP		
Long Term Rating	AA/Watch Neg	On CreditWatch Negative
Alaska GO		
Long Term Rating	AA+/Watch Neg	On CreditWatch Negative

Ratings Detail (As Of June 9, 2016) (cont.)		
Alaska Energy Auth, Alaska		
Alaska		
Alaska Energy Auth (Alaska) pwr rev (Bradley Lake Hydroelectric Proj)		
Long Term Rating	A+/Watch Neg	On CreditWatch Negative
Alaska Mun Bnd Bank, Alaska		
Alaska		
Alaska Mun Bnd Bank (Alaska) master resolution GO bnds (Alaska) ser 2016A due 10/01/2024		
Long Term Rating	AA/Watch Neg	On CreditWatch Negative
Alaska Mun Bnd Bank (Alaska) GO		
Long Term Rating	AA/Watch Neg	On CreditWatch Negative
Alaska Mun Bnd Bank (Alaska) GO and rfdg bnds ser 2016 SER 2 due 12/01/2035		
Long Term Rating	AA/Watch Neg	On CreditWatch Negative
Alaska Mun Bnd Bank (Alaska) GO (AMBAC)		
Unenhanced Rating	AA(SPUR)/Watch Neg	On CreditWatch Negative
Alaska Mun Bnd Bank GO		
Unenhanced Rating	AA(SPUR)/Watch Neg	On CreditWatch Negative
Matanuska-Susitna Boro, Alaska		
Alaska		
Matanuska-Susitna Boro (Alaska) lse rev rfdg bnds (Alaska) (Goose Creek Correctional Ctr Proj)		
Long Term Rating	AA/Watch Neg	On CreditWatch Negative
	NR(prelim)	
Matanuska-Susitna Boro (Alaska) lse rev (Goose Creek Correctional Facs) (ASSURED GTY)		
Unenhanced Rating	AA(SPUR)/Watch Neg	On CreditWatch Negative

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.