FITCH RATES ALASKA'S $31MM COPS 'AA+'; AFFIRMS OUTSTANDING GOS AT 'AAA'

Fitch Ratings-New York-11 August 2014: Fitch Ratings has assigned an 'AA+' rating to $30.95 million state of Alaska certificates of participation (COPs), series 2014 (Alaska Native Tribal Health Consortium Housing Facility Project).

The COPs are expected to sell via negotiation on or about Aug. 25, 2014.

In addition, Fitch has affirmed the following ratings:

-- approximately $690.6 million of outstanding state of Alaska general obligation (GO) bonds at 'AAA';
-- approximately $268.8 million of outstanding state of Alaska appropriation bonds and COPs including the Matanuska-Susitna Borough, Alaska Goose Creek Correctional Center Project lease revenue bonds, series 2008 and the Anchorage, Alaska correctional facilities lease revenue refunding bonds series 2005 at 'AA+'.

The Rating Outlook is Stable.

SECURITY
The COPs are secured by lease rental payments from the Alaska Department of Administration (DOA), subject to legislative appropriation from the state's general fund.

KEY RATING DRIVERS

ANNUAL APPROPRIATION OBLIGATION: The 'AA+' rating on the COPs is based on the credit quality of the state (GO bonds rated 'AAA' by Fitch) as the COPs are secured by annual legislative appropriations from the state's general fund.

VERY LARGE RESERVES: Alaska has set aside very large reserves for general fund operating needs, principally in the Constitutional Budget Reserve Fund (CBR) and Statutory Budget Reserve Fund (SBR), two of the state's most accessible reserve funds. The state expects to apply windfall revenue deposited to the SBR from high oil prices to fund general fund (GF) expenses in the current forecast as oil price and production have tapered. The maintenance of sizable reserves as the state adjusts its financial position remains key to the assigned rating. The state's reserves provide multiple-times coverage of its debt obligations.

CONSERVATIVE FINANCIAL MANAGEMENT: Conservative financial management is critical given the state's dependence on energy-related revenues and the volatility of energy prices and production. Fitch expects Alaska to manage its reserve funds prudently and promptly adjust its expenditures as needed, consistent with the state's historical practice.

ECONOMY AND FINANCES DEPENDENT ON NATURAL RESOURCES: While both natural resources and the federal government have provided sources of employment and income to Alaska's small population, the volatility inherent in the natural resource industry is the state's area of vulnerability. Petroleum-related revenue accounts for approximately 84% of general fund revenue.

MANAGEABLE LIABILITY POSITION: Alaska's debt burden is moderate. The state has prudently used available cash to fund its capital needs and cash-defeased outstanding obligations when costeffective. Although the funded ratios of Alaska's major statewide pension systems are weak, the state's recent deposit of $3 billion from its CBR has improved system funding. In addition, about half of the state's other post-employment benefit (OPEB) obligations are pre-funded.

RATING SENSITIVITIES

The rating is sensitive to shifts in the state's GO bond rating to which it is linked. Key fundamental credit characteristics include proactive management of its financial operations and a commodity-based economy.

CREDIT PROFILE

The COPs being offered will provide funding for the construction of a residential housing facility and related elevated pedestrian bridge to serve the Anchorage campus of the 150-bed Alaska Native Medical Center (ANMC) that is operated by the not for profit Alaska Native Tribal Health Consortium (ANTHC). The ANTHC assumed responsibility for the provision of Indian Health Services (IHS)-funded health care services in Alaska in 1999 through the authority of the federal Indian Self-Determination and Education Assistance Act. IHS is an agency of the U.S. Department of Health and Human Services.

The state DOA is providing funding for the project in order to achieve expected annual savings in the state's Medicaid budget. Title and leasehold interest in the project remain with the state until the COPs are repaid, at which time title will be transferred to the ANTHC for no additional consideration. The facility will be constructed and operated by the ANTHC, and debt service on the 15-year COPs will be paid by the DOA by deposits to the trustee through its annual budget appropriation from the state's general fund.

Alaska's 'AAA' GO rating reflects the state's maintenance of very substantial reserve balances and the continuation of conservative financial management practices at a time when recent revenue performance has weakened due to lower production. State revenues are linked closely to oil production from the North Slope and global petroleum price trends, exposing the state to significant revenue volatility. Mitigating this risk, state fiscal practices are generally conservative, and the state has historically dedicated a substantial share of oil-related revenue to reserves and employed long-range forecasting of revenues and expenses. The current state baseline forecast contemplates the application of reserve balances through the forecast period to fiscal year 2024 as oil production in the state is projected to continue to taper. Reserve balances have grown exponentially over the past several fiscal years and, despite the planned applications, Fitch believes the state is committed to keeping reserve levels high.

Debt practices are conservative, with limited issuance and average amortization. Employment remains generally stable. Although the state has potential exposure to federal employment cutbacks tied to budget pressures at the federal level, its revenue system limits its budget exposure.

RESOURCE-DEPENDENT REVENUE SYSTEM

Alaska's economic and financial performance is tied closely to its natural resource base, with 84% of general fund revenues derived from petroleum-related activity for fiscal year (FY) 2014. Fluctuating global energy prices have led to sharp surges and drops in the state's unrestricted general fund revenues in related fiscal years with recent revenue growth through FY 2012 enabling sizable growth in the state's various reserve funds. The CBR and SBR together grew from $8.1 billion in FY 2009 to $15.9 billion in FY 2012 and the fund balance of the state's permanent fund increased from $29.9 billion to $40.3 billion over this same timeframe.

Lower oil prices and decreased production beyond the state's expectations in FY 2013 resulted in a net appropriation of $526.5 million from the SBR to the GF for operations, yet the SBR's balance was able to increase that year to $4.8 billion due to solid growth in investment earnings on the fund.

Combined, the CBR and SBR grew to $17.1 billion due to the CBR's receipt of tax and royalty settlement payments in addition to investment earnings on the account. The permanent fund reached $44.7 billion in that fiscal year with the portion in the earnings reserve, a more accessible portion of the fund, accounting for $4.1 billion of that balance. On a GAAP basis, FY 2013 ended on June 30, 2013 with a $1.1 billion GF surplus, bringing the GF balance to $22.6 billion; more than 2.8x total non-federal GF revenue.

Also in 2013, the state legislature enacted the governor's proposal to change the method of calculating oil production tax revenue with the passage of the More Alaska Production Act (MAPA). Starting on Jan. 1, 2014, oil production on the North Slope of Alaska will be taxed at 35% of the net value of that production (rather than under the prior taxing system where tax rates increased with additional production), with a credit for each barrel of oil produced and a special reduction in taxes for new oil developments. The state forecasts an increase of $10 billion in investment over the next 10 years; however, the incentives for increased development are expected to result in decreases in revenue related to the deductibility of lease expenditures and cost of transporting oil against production taxes and royalties.

For FY 2014, oil prices and production improved toward the close of the fiscal year that ended on June 30, above the revised spring 2014 revenue forecast (from April 2014) which was an improvement on the fall 2013 revenue forecast but still below original budget expectations. The spring 2014 revenue forecast projected North Slope West Coast oil prices to average $106.71 per barrel in FY 2014; actual oil price per barrel is estimated at over $107. While both estimates are above the $105.68 per barrel forecast in the fall of 2013 they are still below the $109.61 forecast on which the FY 2014 budget was based. Actual oil production also improved over the course of the fiscal year, with final oil production estimated at over 0.529 bbl/day; up from the fall 2013 forecast of 0.508 bbl/day and just above the 0.527 bbl/day budget forecast. While final numbers for fiscal 2014 are not yet available, the negative revision is expected to have reduced total expected revenue to the GF to below the budgeted $6.16 billion, while also increasing the amount expected from the SBR to fund GF operations.

The enacted FY 2015 operating budget forecasts oil prices decreasing to $105.06 per barrel, with a slight decline in oil production assumed. FY 2015 unrestricted general fund revenues are forecast at $4.5 billion, a 15.3% decline from estimated revenues in FY 2014, incorporating the reduced expectation for production tax revenue, decreased revenue related to various tax changes, and the close-out of outstanding capital credits issued under the prior oil production tax system. The enacted $5.8 billion in recurring and discretionary appropriations is a substantial 20.3% less than the prior year, incorporating a $715.5 million cut in capital expenditures and a $767.7 million cut in statewide and supplemental expenditures. The budget includes a $1.38 billion transfer from the SBR to fund expenditures as well as a $3 billion transfer from the CBR to be deposited to the state's pension systems to improve funded ratios.

VERY LARGE RESERVE FUNDS

As noted above, the state has prudently set aside much of its past revenue windfalls in the CBR and SBR. Deposits of surplus funds as well as dedicated petroleum dispute settlement funds have brought the CBR's balance to over $11 billion and the SBR's balance to $3.72 billion as of July 31, 2014. In addition, over $1 billion has been set aside for pre-funding school formula payments. Additional balances available to the state include realized earnings of the $50.6 billion Alaska Permanent Fund (as of Aug. 4, 2014), measuring about $5 billion. These reserves may be accessed by the state by a majority vote of the legislature, with access to the CBR restricted to a three-fourths majority vote of the legislature should the general fund not be in a deficit situation; a simple majority is required in a deficit situation. The pre-funded balance for education, equal to about one year of education expense, does not require a vote of the legislature for its use.

While financial operations in FY 2014 reduced the SBR by about $1.7 billion and the CBR will be reduced by the $3 billion allocation in FY 2015 to shrink the unfunded liability of the state's pension systems, these accounts remain substantial in relation to outstanding debt obligations and Fitch expects the state to prudently manage the application of these reserves, when such action is warranted, and realign its discretionary expenditures as necessary. The application of $3 billion of the CBR in FY 2015, while reducing financial cushion, is expected to result in lower annual required contributions to the pension systems, thereby providing out-year financial flexibility to the state; an important consideration as oil production declines and use of these reserves are continue to be forecast.

The state's spring 2014 forecast of increasing future oil prices combined with declines in production is expected to result in fairly steady unrestricted GF revenue losses through the FY 2023 forecast period. In February 2014, based on fall 2013 projections, the state forecast a depletion of the SBR in fiscal 2018 while the CBR reaches a low balance of about $8 billion in FY 2024. The spring 2014 forecast was an improvement on the earlier forecast and both oil price and production have improved since the spring, creating the potential for some positive results on reserve balances.

MANAGEABLE LIABILITY POSITION
The state is an infrequent debt issuer, meeting most capital needs from current revenues. The debt burden as of June 30, 2013 is manageable, with $1.14 billion in net tax-supported debt measuring 3.1% of personal income after excluding guaranteed debt of the Housing Finance Corporation, which has never required state support, and reimbursable school debt. Expected borrowing for state transportation projects will increase the debt- to-personal income ratio, although Fitch notes that as the majority of state debt is repaid from petroleum-related revenue the debt-to-income ratio is not as meaningful for Alaska as for other states.

The pensions for two major statewide systems, for general public employees and for teachers, were funded at 57.1% and 49.9%, respectively, as of June 30, 2013 based on the systems' 8% investment return assumption. Using Fitch's more conservative 7% assumption, the funded ratios decline to 51.5% and 45%, respectively. OPEBs alone are funded at 54% for general public employees and 33.2% for teachers, as of June 30, 2013. The state has undertaken multiple pension reforms in recent years, including switching to defined contribution plans for new employees beginning July 1, 2006, and legislation enacted in 2007 obligating the state to assume local governments' contributions over a fixed percentage of payroll. The application of $3 billion of CBR funds to the unfunded liabilities of these systems is expected to improve the systems' funded ratios. The state has no current plans to issue the up to $5 billion in pension obligation bonds that were authorized in 2008.

Contact:
Primary Analyst
Marcy Block
Senior Director
+1-212-908-0239
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Douglas Offerman
Senior Director
+1-212-908-0889

Committee Chairperson
Laura Porter
Managing Director
+1-212-908-0575

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from IHS Global Insight.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria', dated Aug. 14, 2012;
--'U.S. State Government Tax-Supported Rating Criteria', dated Aug. 14, 2012.

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033