STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Summary:

Alaska; Appropriations; General Obligation; Moral Obligation

Primary Credit Analyst:
Gabriel J Petek, CFA, San Francisco (1) 415-371-5042; gabriel.petek@standardandpoors.com

Secondary Contact:
David G Hitchcock, New York (1) 212-438-2022; david.hitchcock@standardandpoors.com

Table Of Contents

Summary:

Alaska; Appropriations; General Obligation; Moral Obligation

Credit Profile		
US$30.95 mil certs of part (Alaska Native Tribal Health Consortium Hsg Fac Proj) ser 2014 due 06/01/2029		
Long Term Rating	AA+/Stable	New
Alaska GO		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
Alaska Mun Bnd Bank, Alaska		
Alaska		
Alaska Mun Bnd Bank GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' rating to Alaska's $30.95 million series 2014 certificates of participation (COPs). At the same time, we affirmed our 'AAA' long-term rating and underlying rating (SPUR) on Alaska's previously issued general obligation (GO) bonds, our 'AA+' rating and SPUR on the state's existing appropriation-backed COPs and Alaska Municipal Bond Bank's moral obligation appropriation-backed bonds, and our 'AA' rating on some of the state's moral obligation-backed debt. The outlook on all the ratings is stable.

The ratings reflect our view of the state's:

- Strong financial management and relatively accurate forecasting practices, which we view as beneficial to credit because of the state's reliance on volatile oil-derived revenue (which fluctuates with the price and level of oil production);
- Financial flexibility enhanced by the maintenance of large reserves derived from prior windfall receipts of oil production-related revenue and the prefunding of a substantial portion of the proceeding years' expenditures with current-year revenue; and
- Moderate debt burden, significant pay-as-you-go financing of capital needs, and closed defined-benefit retirement system despite a relatively large lingering unfunded actuarial accrued liability.

More specifically, the COP ratings reflect our view of the strength of the appropriation pledge and the legislature's demonstrated commitment to including the appropriation in the state's annual operating budget.

Certificate proceeds will be used to finance the construction of a residential housing facility and related pedestrian infrastructure intended to serve the Anchorage campus of the Alaska Native Medical Center (ANMC), which will serve as the leased asset. Pursuant to state legislation, the state, acting through its Department of Administration (DOA), will enter a lease purchase agreement to lease-purchase the Alaska Native Tribal Health Consortium housing facility.

Under a facility lease and trust agreement, the state's DOA will make lease payments to the trustee from annual appropriations made by the state legislature.

The leased assets consist of a design-bid-build project to construct a six-floor, steel-frame, 170-plus-room housing facility connected to the ANMC hospital via a sky bridge. When completed, the 95,000-square-foot facility will be open to patients who have traveled 90 miles or more from outside of Anchorage to be seen at ANMC. The building will also feature prematernal and family housing, gathering and quiet areas, a business center, a shared kitchen, a guest laundry, and expanded dining facilities.

There is no capitalized interest period, and required lease payments under the lease are not subject to project completion or abatement. The first year's lease payment has already been appropriated by the state legislature, and pledged lease payments are an absolute "triple net" obligation of the state and are not subject to abatement for damage to the facility or to right of set-off as long as the lease is annually renewed. The state covenants to maintain liability and fire and extended coverage property insurance, which under the agreement it may do via self-insurance.

There is no debt service reserve, but the Dec. 1 interest and June 1 interest and principal payment dates allows sufficient time, in our opinion, to cover late state budget risk.

Alaska general creditworthiness

Alaska's economy and finances are highly resource dependent, with more than 90% of general fund revenue being oil related. To a significant extent, the state's financial management has helped offset the near-term fiscal effects of revenue volatility, which is inherent to its oil-reliant economy. The state has done this by constructing multiple layers of reserves and extensive operating flexibility. Among the most prominent of these are:

- An accumulation of multiple budget reserves equal to well over 200% of the general fund budget;
- A high level of pay-as-you-go financing of capital needs, which could be reduced to fund operations if the state deems doing so necessary;
- Extensive forward-funding of significant areas of the state's operating budget, a practice that could be halted in an underperforming revenue environment;
- Twice the constitutionally required contributions to the state permanent fund of revenue from oil and gas rentals, royalties, and leases; and
- Untapped potential sources of tax revenue, such as statewide sales or personal income taxes, neither of which the state levies at present.

According to estimates from the state's Office of Management and Budget (OMB), Alaska's general fund ended fiscal 2014 with an operating budget deficit of $1.7 billion. Transfers from the state's reserve funds, which total $15.5 billion (220% of expenditures) at fiscal year-end bridged the difference. There is additional flexibility beyond what is provided by the reserves in the state's fiscal structure because of its practice of prefunding major expenditures, such as for education and municipal revenue sharing. For example, in fiscal 2014, $1.2 billion of state expenditures prefunded education costs for fiscal 2015.

For fiscal 2015, the enacted budget reduced general fund spending by 16.2%, to $5.9 billion from $7.1 billion in fiscal 2014 (although it continues to prefund education, with an appropriation of $1.3 billion for fiscal 2016). Despite curtailing spending, the state estimates that revenues, at $4.5 billion, will still fall short of expenditures by roughly $1.4

billion in fiscal 2015. The funding gap will be met by transfers from the state's statutory budget and constitutional budget reserves, which had a combined balance of $15.5 billion at the end of fiscal 2014. Projections show that by the end of fiscal 2015, the combined balance will decline by more than the operating deficit, however. That's because the state has approved a $3 billion extraordinary transfer to its retirement systems. After financing the state's operating deficit and funding the retirement system deposit, the OMB estimates that the state's combined reserve balance will total $11.8 billion, or 167% of general fund expenditures.

Whereas a structural budget gap equal to that of Alaska's would equate to immediate pressure on most states' credit quality, we believe the rating on Alaska can withstand the imbalance for a time. But we do not view the imbalance as risk free, however, especially as we look beyond the two-year time frame of our outlook horizon. For one, the state's multiple-year fiscal forecast assumes that state spending will be held flat at the level proposed by the governor for fiscal 2015. Building the forecast with this assumption allows that, by the end of 2024, and after 10 years of deficit spending, the state's budget reserves would still be at a very strong level, at just under $8 billion, or 142% of expenditures. In addition to this, the Alaska Permanent Fund Corp. forecasts that the permanent fund earnings reserve will have a $9.3 billion balance by 2024. This would bring the state's total available budget reserves to 308% of expenditures. But in light of upward pressures on state health care expenditures, we believe the actual structural deficit could prove to be larger. The governor's 10-year fiscal forecast indicates that Medicaid-related costs could increase at a 7.2% annual rate.

Considering the importance of oil-related revenue to the state's budget, the state's oil prices and production are crucial to its fiscal condition. The state's Department of Revenue (DOR) has a good track record of forecasting year-ahead prices and production levels. In recent years, the state's price forecasts have tended to err slightly on the low side (except for fiscal 2009, when actual Alaska North Slope West Coast oil prices came in at $68.34, almost 18% below the $83.04 that the state had forecast the year prior). Similarly, the state's forecast of production levels has been highly accurate for the one-year horizon. For fiscal 2012, the state forecast was less than one percentage point below actual production, and for fiscal 2013, the state estimates that its forecast from the previous fall will prove to have been just 0.43% higher than the actual price.

A bigger issue for the state is measuring the long-term rate of oil production decline. Since peaking in 1988, the average annual rate of decline in production has been about 5.5%. However, the state's previous forecast methodology had consistently projected a long-term rate of annual production decline of just 2.5% or less. As a result, the state's long-term forecast has tended to overestimate actual production levels. Beginning with its fall 2012 forecast, the DOR has followed a revised long-term production forecast methodology. The new approach applies risk factors to discount the projected oil production from oil fields that are still under development or in the evaluation stage. Previously, production estimates in the forecast from such fields were not adjusted downward to account for their higher level of uncertainty.

Total state net tax-supported GO and general-fund-supported lease debt is moderate, in our view, at $1,515 per capita (not including municipal school debt and local government capital projects that the state has frequently reimbursed or self-supporting GO bonds that the state has issued through its housing corporation and that are backed by veterans' housing loans). Fiscal 2013 tax-supported GO and appropriation debt service was moderate, at 1.2% of general fund and nonmajor special governmental fund expenditures, not including discretionary state reimbursement for local school debt.

Based on the analytic factors we evaluate for states, on a four-point scale in which '1' is the strongest, Standard & Poor's has assigned a composite score of '1.7' to Alaska. Although this score is indicative of a 'AA+' rating under our criteria, we have viewed the state's credit quality as warranting the 'AAA' rating because of its uncommonly high budget reserve levels.

Outlook

The stable outlook reflects our opinion that the state, having effectively managed prior revenue windfalls, has amassed very high reserves. In our view, the budget reserves enable the state to weather a period of structural budget imbalance through at least our two-year outlook horizon. In light of the state's revenue volatility, we anticipated that in some years the state would rely upon the reserves it had accumulated during the stronger years. But if production levels don't stabilize and market prices fall approximately in line with the state's forecast, it could be facing an extended period of structural budget deficit. Even with 10 consecutive years of operating deficits, the state's forecast shows it could still have budget reserves equal to 140% of annual expenditures. But we believe there is some risk that the ending reserve forecast could prove optimistic if, as we expect, actual expenditures exceed the state's forecast. Absent other adjustments, therefore, the annual budget deficits could begin to exert downward pressure on the state's rating. These pressures could accelerate if oil prices were to fall materially below the state's forecast. In addition, the governor's proposal to make a large transfer to the pension trusts, while helpful to their funding level in the short run, also includes a weaker element in our view. By also proposing to cap the state's annual contribution to the pension trusts, the governor's recommendation could mean that the state contributes less than the annual required contribution in future years. This would represent a weaker approach under our criteria and could contribute to a lower funded ratio in future years, especially if investment performance for one or more years was weaker than assumed.

Related Criteria And Research

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions, Nov. 19, 2013

Related Research

U.S. State And Local Government Credit Conditions Forecast, July 8, 2014

Ratings Detail (As Of August 7, 2014)		
Alaska GO		
Long Term Rating	AAA/Stable	Affirmed
Alaska GO bnds (Qscb) ser 2013A due 08/01/2035		
Long Term Rating	AAA/Stable	Affirmed
Alaska COPs (State Virology Lab Facs)		

Ratings Detail (As Of August 7, 2014) (cont.)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Alaska Energy Auth, Alaska		
Alaska		
Alaska Energy Auth (Alaska) pwr rev (Bradley Lake Hydroelectric Proj)		
Long Term Rating	AA/Stable	Affirmed
Alaska Mun Bnd Bank, Alaska		
Alaska		
Alaska Mun Bnd Bank (Alaska) GO		
Long Term Rating	AA+/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO bnds (Alaska) ser 2014A due 03/01/2039		
Long Term Rating	AA+/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO bnds (Alaska) ser 2014B due 03/01/2030		
Long Term Rating	AA+/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO bnds (Alaska) ser 2014-2 due 06/01/2044		
Long Term Rating	AA+/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO moral oblig (MBIA) (National)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO (AMBAC)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO (Moral Ob)		
Long Term Rating	AA+/Stable	Affirmed
Alaska Mun Bnd Bank GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Anchorage Municipality, Alaska		
Alaska		
Anchorage Municipality (Alaska) lse rev rfdg bnds (Correctional Facility) ser 2005		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Matanuska-Susitna Boro, Alaska		
Alaska		
Matanuska-Susitna Boro (Alaska) lse rev (Goose Creek Correctional Facs) (ASSURED GTY)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.