Fitch Ratings

FITCH RATES ALASKA'S $170MM GO BANS 'F1+'; AFFIRMS OUTSTANDING GOS AT 'AAA'

Fitch Ratings-New York-03 March 2014: Fitch Ratings has assigned an 'F1+' rating to $170 general obligation (GO) bond anticipation notes (BANs), series 2014 (non-callable) of the state of Alaska (the state).

The BANs are expected to sell via competitive sale the week of March 10, 2014 and will mature on March 23, 2015.

In addition, Fitch affirms the following ratings:

--'AAA' rating on approximately $690.6 million of outstanding state of Alaska GO bonds;
--'AA+' rating on approximately $268.8 million of outstanding state of Alaska appropriation bonds and certificates of participation 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.

The Rating Outlook is Stable.

SECURITY
General obligations to which the full faith, credit and resources of the state are pledged.

KEY RATING DRIVERS
SHORT-TERM RATING: The 'F1+' rating on the notes reflects the strong likelihood of market access to redeem the notes by the issuance of up to $453.5 million of long-term GO bonds already authorized by qualified voters for state transportation projects.

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) expense 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 prudently manage its reserve funds 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 92% of unrestricted 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 cost-effective. Although the funded ratios of Alaska's major statewide pension systems are weak, the state has undertaken significant pension reforms and closed its defined benefit plans to new employees in 2006. In addition, about half of the state's other post-employment benefit (OPEB) obligations are pre-funded.

RATING SENSITIVITIES

Changes in the state's 'AAA' GO bond rating to which this rating is linked.

CREDIT PROFILE

The notes being offered will redeem $142.645 million in currently outstanding notes issued in 2013, as well as provide approximately $30 million in additional funding, under authorization obtained from qualified voters under the State Transportation Bond Act (the Bond Act) for the design and construction of state transportation projects. The total authorization of $453.5 million will provide funding for various port, rail, highway, and road projects in the state. The resolution authorizing these notes includes authorization for their redemption by GO bonds issued pursuant to the Bond Act.

The state'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 than expected oil prices and 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 continues 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. The economy remains 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 88% of unrestricted general fund revenues derived from petroleum-related activity estimated 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 have also been trending below the state's expectations. The fall 2013 revenue forecast current North Slope West Coast oil prices to average $105.68 per barrel in FY 2014; below the $109.61 per barrel forecast on which the budget was based. A revised estimate for oil production is also lagging forecast in FY 2014; 0.508 bbl/day now anticipated, down from 0.527 bbl/day forecast. These revisions have reduced total expected revenue to the GF to $4.96 billion from the earlier expected $6.16 billion, while also increasing the amount expected from the SBR to fund GF operations to $1.9 billion from $667.9 million. Combined, the SBR and CBR are expected to decline to $15 billion; equal to 2.2x recurring and discretionary general fund expenditures.

The governor has proposed a FY 2015 operating budget that forecasts oil prices decreasing slightly 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, an 8.7% decline from anticipated 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 proposed $5.57 billion in recurring and discretionary appropriations is a substantial 22.7% less than the prior year, incorporating an $846.6 million proposed cut in capital expenditures and a $772 million cut in statewide and supplemental expenditures. The proposal includes a $1.1 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. The budget proposal is being considered in the current legislative session.

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 $12 billion while the SBR's balance has grown to $4.77 billion, and over $1 billion has been set aside for pre-funding school formula payments. Additional balances available to the state include realized earnings of the $43.6 billion Alaska Permanent Fund, measuring about $4 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. 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 the current fiscal year are expected to reduce the SBR and CBR combined balances to $15 billion, 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 governor's proposal to apply $3 billion of the CBR in FY 2015 to the unfunded liability of the state's pension systems, while reducing financial cushion, would result in lower annual required contributions, 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 fall 2013 forecast of increasing future oil prices combined with declines in production, assuming the maintenance of baseline general fund expenditures at $5.6 billion, is expected to result in fairly steady unrestricted GF revenue losses through the FY 2024 forecast period. Under this scenario, the SBR is forecast to be depleted in fiscal 2018 while the CBR reaches a low balance of about $8 billion in FY 2024. The updated forecast is a substantial revision to that one year prior, which estimated a peak CBR balance of $16 billion in FY 2021 that has now been revised to a peak balance of $10.9 billion in fiscal 2019, but the forecast does include the governor's proposed $3 billion transfer to the pension systems.

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. Fitch expects the governor's proposal to apply CBR funds to the unfunded liabilities of these systems to be discussed in the current legislative session. The state has no current plans to issue up to $5 billion in pension obligation bonds that were authorized in 2008.

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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;
--'Rating Municipal Short-Term Debt', dated Dec. 9, 2013;
--'U.S. State Government Tax-Supported Rating Criteria', dated Aug. 14, 2012.

Applicable Criteria and Related Research:
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
Rating U.S. Municipal Short-Term Debt -- Effective Nov. 27, 2012 to Dec. 9, 2012
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