STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Alaska
Alaska Municipal Bond Bank; Appropriations; General Obligation; Moral Obligation; Note

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

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Credit Profile		
US$195.0 mil GO bnd antic nts (Alaska) ser 2014 due 03/23/2015		
Short Term Rating	SP-1+	New
Alaska GO		
Unenhanced Rating	AAA(SPUR)/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 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

Rationale

Standard & Poor's Ratings Services assigned its 'SP-1+' rating to Alaska's $195 million series 2014 bond anticipation notes (BANs). At the same time, we affirmed our 'SP-1+' rating on the state's series 2013 BANs, which we understand the state intends to refinance with the proceeds from the 2014 BANs. We also affirmed our 'AAA' rating on Alaska's previously issued general obligation (GO) bonds, our 'AA+' rating on the state's appropriation-backed certificates of participation, and our 'AA' rating on some of the state's moral obligation-backed debt. The outlook, where applicable, on all 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 (UAAL).

The BANs and GO bonds are backed by the state's full faith, credit, and resources. In practice, we anticipate that the state will use proceeds from a future BAN or GO bond issue to retire the notes. Specifically, we expect the state will issue GO bonds against a portion of the $453.5 million in GO bonding authority that voters approved in November 2012 to repay the BANs. Voters approved the GO bonds in order to fund the design and construction of various transportation projects in the state. The BANs will allow the state to commence paying for the preliminary costs of the state transportation projects.

In accordance with our criteria for rating BANs, we have assigned a "low" market risk profile to Alaska. Across the board, Alaska scores favorably in our assessment of its market risk. This includes the explicit BAN refunding authority referenced above, no debt that is sensitive to market confidence exposure, and good information availability.

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.

In a demonstration of its dependence on oil production and prices, Alaska's revenue situation has deteriorated during the past year, especially after mid-September, when current and expected oil prices began to slide. Just 12 months earlier, in December 2012, the state had projected that unrestricted general fund revenues would top $7.0 billion in fiscal 2014. But its updated forecast in December 2013 dropped the revenue estimate for fiscal 2014 by more than $2 billion, to $4.9 billion. The more recent forecast assumed a lower price per barrel (PPB) and less oil production than the one from late 2012. The state now forecasts a PPB of $105.68 and 508,200 barrels per day (BPD) in production, both of which are below the earlier projections and had been at $109.61 and 538,000, respectively. One consequence of the updated forecast is that a structural gap has emerged between recurring revenues and baseline general fund expenditures. And because the state also forecasts that the PPB will increase only gradually while production will continue to follow a declining trajectory, the budget deficits persist through the state's 10-year forecast horizon. The state's very strong reserve position, nevertheless, allows its credit quality to remain very strong at this time, in our view.

In December, when the governor presented his fiscal 2015 budget proposal, the state also updated its forecast for fiscal 2014. Incorporating the new lower revenue forecast, the fiscal 2014 budget is on course to see its general fund spending outpace revenues by $1.95 billion, equal to about 38% of expenditures. The state is still expected to end the year with budgetary reserves of more than $15 billion, or 217% of general fund expenditures. 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 fiscal 2013, its prefunding activity totaled $1.3 billion. And in fiscal 2014, for example, the state is spending $1.2 billion to prefund education costs for fiscal 2015. The governor's fiscal 2015 budget proposal includes $1.2 billion to prefund education for fiscal 2016.

For fiscal 2015, the governor proposes reducing general fund spending by 18.4%, bringing it down to $5.6 billion from $6.9 billion in fiscal 2014. Despite proposing to curtail spending, the state estimates that revenues, at $4.5 billion, would still fall short of expenditures by around $1.1 billion in fiscal 2015. The funding gap would be met by transfers from the state's statutory budget reserve, which had a balance of $4.8 billion at the end of December 2013. Combined with the state's constitutional budget reserve (CBRF, which had a balance of $12.2 billion at the end of December 2013), under the governor's proposal, it would fall to $11.4 billion by the end of fiscal 2015 Including the state's permanent fund earnings reserve balance (which can be drawn upon with a majority vote of the legislature), projected at $4.66 billion, the state's total reserves would still be equal to $16.0 billion, or 284% of expenditures. Reserve balances would decline by more than the budget gap because the governor also proposes to make a large, $3 billion transfer to the state's two main pension trusts from the CBRF. But even after funding the budget deficit and the pension transfer, the remaining combined budget reserve balances at the end of fiscal 2015 would equal 204% of 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 timeframe 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 very strong levels, 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.

In addition, while the governor proposes to infuse the state pension trusts with a $3 billion transfer of funds from the CBRF, he also proposes that the state cap its funding contribution at no more than $500 million per year thereafter. In effect, he proposes that the state back away from committing to fund the annual required contribution (ARC). The state's defined benefit pension benefit system has been closed since 2006. But as the composition of members is increasingly represented by retirees instead of contributing employees, it leaves a burdensome liability for the state and other governmental employers in Alaska. In our view, moving away from a commitment to funding the ARC could lead to future pressure on the state's credit quality and rating, notwithstanding the proposed $3 billion capital infusion in fiscal 2015.

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, or ANS, 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 around 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. With its fall 2012 forecast, the DOR has revised the methodology used to develop its longer-term production forecast. 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 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 non-major 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 anticipation 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 it 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 ARC 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
- USPF Criteria: Bond Anticipation Note Rating Methodology, Aug. 31, 2011
- USPF Criteria: Moral Obligation Bonds, June 27, 2006
- 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, Dec. 17, 2013

Ratings Detail (As Of March 3, 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 GO BANs		
Short Term Rating	SP-1+	Affirmed
Alaska COPs (State Virology Lab Facs)		
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 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
Anchorage Municipality, Alaska		
Alaska		

Ratings Detail (As Of March 3, 2014) (cont.)		
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.		

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