# State of Alaska

## General Obligation Bonds
## Full Rating Report

### Ratings

| | |
|---|---|
| General Obligation Bonds[a] | AAA |
| Certificates of Participation | AA+ |

[a]Upgraded from AA+ on Jan. 7, 2013.

### Rating Outlook

Stable

### Related Research

Fitch Rates Alaska's $150MM GO BANs 'F1+'; Affirms Outstanding GOs at 'AAA' (February 2013)

Fitch Rates $94MM Alaska Municipal Bond Bank GOs 'AA+'; Outlook Stable (February 2013)

2013 Outlook: North American Oil & Gas (December 2012)

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## Key Rating Drivers

**Very Large Reserves:** Alaska (the state) 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). The state has used recent windfalls from high oil prices to repay past CBR draws and remains committed to maintaining sizable reserves, a key rating factor given forecast declines in oil production over time. The state's reserves provide multiple times coverage of its debt obligations.

**Conservative Financial Planning:** Conservative financial management is critical for the state, given its dependence on volatile energy-related revenues. Fitch Ratings expects Alaska to prudently manage its reserve funds and promptly adjust its expenditures as needed, consistent with the state's historical practice.

**Dependence On Natural Resources:** While both natural resources and the federal government provide significant sources of employment and income to Alaska's small population, the state's area of vulnerability is the instability inherent to the natural resource industry. 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, including closing its defined benefit plans to new employees in 2006. In addition, about half of the state's other postemployment benefit (OPEB) obligations are prefunded.

## Rating History

| Rating | Action | Outlook/ Watch | Date |
|---|---|---|---|
| AAA | Upgraded | Stable | 1/7/13 |
| AA+ | Affirmed | Stable | 8/23/10 |
| AA+ | Revised | Stable | 4/5/10 |
| AA | Assigned | — | 5/2/94 |

### Related Criteria

Tax-Supported Rating Criteria (August 2012)

U.S. State Government Tax-Supported Rating Criteria (August 2012)

## Credit Profile

Alaska's 'AAA' GO bond rating reflects the state's maintenance of very substantial and growing reserve balances and conservative financial management practices at a time of strong revenue performance. 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, with the state dedicating a substantial share of oil-related revenue to reserves and employing long-range forecasting of revenues and expenses. Reserve balances have grown exponentially over the past several fiscal years, and Fitch believes the state is committed to keeping reserve levels high.

Development of a natural gas pipeline from the North Slope, completion of which would help diversify state revenues, continues. Future oil production, even with the development of undiscovered oil fields, is expected to continue its downward trend. 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.

## Debt

### Manageable Liability Position

The state is an infrequent debt issuer, meeting most capital needs from current revenues. The debt burden as of June 30, 2012 was manageable, with $894 million in net tax-supported debt measuring 2.7% of personal income after excluding guaranteed debt of the Housing Finance Corporation, which has never required state support, and reimbursable school debt. The debt burden increased to 3.2% with the issuance of general obligation bond anticipation notes (BANs) for state transportation projects in March 2013. As the state issues debt infrequently, any issuance has a large impact on its debt burden and principal amortization ratios. Fitch notes that as the majority of state revenue is petroleum-related — Alaska does not levy a sales or income tax on its residents — the debt-to-income ratio is not as meaningful for Alaska as for other states. The state does not borrow for noncapital purposes, and capital costs are mostly funded from operating surpluses. Voters recently authorized up to $453 million of GO funding for state transportation capital projects; the recent BAN issue was the first issuance against that authorization. Debt as a percentage of own-source, general fund revenues was 2.5% at the end of fiscal 2012.

General obligation debt accounts for about 30% of Alaska's outstanding gross debt. The state's GO pledge allows it to levy unlimited income and property taxes to pay GO debt service, although there is presently no statewide income or property tax. Leases and COPs comprise 15% of the state's gross debt and have been issued for multiple one-off state facilities over the years, with leases sometimes issued by a local government or by the state's housing agency acting as conduit borrowers for the state.

The state's share of municipal school debt represents the largest component of gross debt at 43%. Depending on the type of project and whether statutory authority to enter the program exists, the state appropriates an annual sum to cover between 60% and 100% of a district's debt service. Of the 21 current participants, 20 are reimbursed at between 63% and 71%. It should be noted that the state does not have a contractual commitment to school districts and can choose not to appropriate; when oil prices were low in the 1990s, for example, the state underappropriated. The state's housing finance agency issues veterans' guaranteed mortgage bonds, which are netted out as self-supporting by Fitch. Alaska does not issue short-term or variable-rate debt and has no exposure to derivatives.

## Debt Statistics

($ Mil., As of June 30, 2012)

| | |
|---|---|
| General Obligations | 575.8 |
| Certificates of Participation | 11.4 |
| Lease Revenue Bonds (Anchorage Jail, Atwood Building and Packaging, Matsu Prison) | 282.2 |
| Municipal School Bonds State Share | 872.6 |
| State Reimbursement for Capital Projects | 24.1 |
| Housing Finance Corp. Guaranteed Bonds (Veterans' Mortgage Program) | 180.1 |
| **Gross Tax-Supported Debt** | **1,946.2** |
| **Less:** | |
| HFC State-Guaranteed Bonds | (180.1) |
| Municipal School Bonds — State Share | (872.6) |
| **Net Tax-Supported Debt** | **893.5** |
| **Debt Ratios** | |
| Net State Debt Per Capita ($) | 1,258.0 |
| Net State Debt as % of Personal Income | 2.7 |
| **Amortization (%)** | |
| **General Obligation Bonds** | |
| Retired Within Five Years | 45.0 |
| Retired Within 10 Years | 53.8 |

In fiscal 2012, the percentage of debt amortizing in 10 years was 54%, a decrease from a high of 65% in fiscal 2010. Maintaining rapid amortization has historically been of concern to Fitch, given the forecast declines in oil production. Lease bonds typically have shorter maturities of 12–15 years, but the amortization of these bonds has slowed as well, with the last issue amortizing over 25 years. In November 2011, the state cash funded an early redemption of $22 million in outstanding COPS, indicating that cash funding of these credits will be a continued priority.

### Alaska Municipal Bond Bank

The state has a credit enhancement program in place for bonds issued by the Alaska Municipal Bond Bank Authority (AMBBA) on behalf of Alaska municipal issuers. The bonds carry a GO pledge of the AMBBA, and issuance requires a GO or revenue pledge or other evidence of pledged revenue of the underlying borrower. Multiple layers of security support bond bank issues in the event of a local government's failure to pay debt service on its obligations to the bond bank. Security enhancements include issuer reserve funds, bond bank reserve funds, the state's statutory moral obligation to replenish bond bank reserve funds and the bond bank's statutory authority to intercept aid to local governments.

Coverage of MADS by state aid is substantial. The 2005 GO resolution bonds are rated 'AA+' by Fitch based on a state standing appropriation for debt service in the event that nonpayment results in a draw on the bond bank reserve fund. The 'AA' rating on the AMBBA's 2010 GO bond resolution, two notches below the state's GO rating, reflects the absence of the bond bank's pledge to seek a standing appropriation for state general fund resources to be used in the event of a program reserve draw.

Both of these programs have recently benefitted from an advance appropriation in the state's budget for debt service, should nonpayment by a borrower result in a draw on the state's debt service fund. As of February 2013, there was $684 million outstanding on the 2005 resolution, while $4.6 million remained under the 2010 resolution. There was also $25 million outstanding on bonds issued under various revenue bond resolutions. In total, as of the end of fiscal 2012, the state had $1.17 billion in outstanding moral obligation debt, of which there has never been a need for state support.

## Retiree Benefits Cannot Be Diminished

Alaska's constitution is one of the few among the U.S. states that explicitly obligate the state to pay both pension and retiree health benefits, which cannot be diminished. The state has statutorily taken on the payment of a portion of local pension obligations because it believes it has a substantial responsibility to local units, although not a constitutional obligation for this liability. There are five retirement systems administered by the state. The two largest are for the state public employees' retirement system (PERS) and the teachers' retirement system (TRS), while the judiciary, military and elected officials have their own small plans. Overall, PERS administers the pensions and OPEB of 160 employers, while TRS administers 58.

As part of pension-reform measures in 2005, the governor signed legislation that closed enrollment in defined benefit plans beginning in 2006, forcing future employees to participate in new, defined-contribution tiers. The legislation created a new pension governing board and mandated yearly actuarial valuations. Another bill in 2007 formed separate trust funds for retiree healthcare and allowed for the reallocation of PERS and TRS assets between the two trusts.

In 2008, PERS became a cost-sharing multiple-employer plan. The same legislation, SB 125, capped the maximum contributions of payroll at 22% and 12.56% for PERS and TRS, respectively, although the state is obligated to make contributions above the statutory level to meet the actuarially required contribution (ARC) for those systems (including OPEB contributions) through annual appropriations. As a result, the state appropriated $242.6 million to PERS and $234.5 million to TRS in fiscal 2012 in addition to its required statutory payments to those systems. For fiscal 2013, the state appropriated $307.3 million to PERS and $302.8 million to TRS to fund the difference between the statutory contribution rate for PERS and the system's ARC rate of 35.84%; the TRS ARC rate is 52.67%.

SB 125 also authorized the issuance of a maximum of $5 billion in pension obligation bonds (POBs) to finance employers' contributions, with debt service on the issue to be paid through annual legislative appropriation. In fall 2008, the state considered issuing up to $2 billion in POBs under the authorization to raise funding levels, but the plan did not proceed. Fitch does not expect issuance of POBs in the short term, but it remains a future possibility. An issuance of $2 billion would push the state's debt to personal income ratio to the highest level among all states, although, as noted above, the personal income metric is not as meaningful for Alaska given the nature of the state's revenue system.

As of June 30, 2012, PERS was funded at 62.4% and TRS at 54.3%. With Fitch's more conservative adjusted ratio that assumes a 7% discount rate, the plans are funded at 56.2% and 48.9%, respectively. Fitch's adjusted unfunded actuarially accrued liability (UAAL) for all the state's plans stands at 10.9% of the state's personal income; combined with outstanding net debt, the ratio increases to 14%, a level that is in the top 20% of states rated by Fitch.

The state's OPEB plans are well funded; PERS is 50.4% funded, while TRS stands at 48.1%.

## GAAP Financial Information

($000, Audited Fiscal Years Ended June 30)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| Taxes | 3,435,465 | 8,257,149 | 4,311,323 | 3,578,905 | 5,358,324 | 7,163,646 |
| Licenses and Permits | 108,660 | 114,669 | 113,988 | 113,995 | 117,310 | 117,873 |
| Charges for Services | 180,292 | 178,835 | 175,723 | 163,896 | 179,309 | 197,080 |
| Fines and Forfeitures | 32,047 | 18,503 | 13,678 | 14,637 | 11,574 | 13,333 |
| Rents and Royalties | 1,606,758 | 2,489,036 | 1,559,849 | 1,548,026 | 1,875,836 | 2,062,103 |
| Premiums and Contributions | 11,988 | 12,625 | 16,595 | 16,348 | 17,787 | 19,017 |
| Interest and Investment Income | 431,222 | 446,107 | (145,218) | 925,117 | 1,158,989 | 309,468 |
| Federal Grants in Aid | 1,993,028 | 1,897,299 | 2,088,385 | 2,394,054 | 2,407,903 | 2,464,928 |
| Other Revenues | 114,443 | 131,783 | 50,655 | 47,774 | 59,540 | 24,406 |
| **Total Revenue** | **7,913,903** | **13,546,006** | **8,184,978** | **8,802,752** | **11,186,572** | **12,411,317** |
| | | | | | | |
| General Government | 276,867 | 516,377 | 677,541 | 365,067 | 388,109 | 399,850 |
| Alaska Permanent Fund Dividend | 658,294 | 990,379 | 2,015,974 | 817,162 | 817,894 | 757,576 |
| Education | 1,303,482 | 1,677,120 | 1,614,892 | 1,669,469 | 1,798,577 | 1,845,251 |
| University | 310,173 | 373,726 | 409,072 | 402,851 | 436,112 | 444,083 |
| Health and Human Services | 1,815,070 | 1,877,353 | 2,059,425 | 2,246,658 | 2,423,401 | 2,569,119 |
| Law and Justice | 178,374 | 207,554 | 201,383 | 302,185 | 236,605 | 277,332 |
| Public Protection | 553,412 | 577,377 | 620,898 | 715,011 | 783,971 | 734,036 |
| Natural Resources | 233,359 | 233,166 | 252,016 | 266,283 | 267,631 | 295,205 |
| Development | 412,559 | 238,540 | 375,980 | 320,285 | 869,912 | 565,558 |
| Transportation | 960,638 | 1,004,380 | 1,081,805 | 1,128,683 | 1,086,107 | 1,122,635 |
| Intergovernmental Revenue Sharing | 61,925 | 128,564 | 231,364 | 177,804 | 189,796 | 254,525 |
| Debt Service | 13,147 | 11,145 | 8,255 | 8,011 | 8,985 | 98,309 |
| **Total Expenditures** | **6,777,300** | **7,835,681** | **9,548,605** | **8,419,469** | **9,307,100** | **9,363,479** |
| | | | | | | |
| Transfers In and Other Sources | 1,260,371 | 1,411,904 | 1,153,833 | 888,631 | 826,289 | 1,040,946 |
| (Transfers Out and Other Uses) | (82,377) | (143,660) | (80,250) | (60,014) | (459,825) | (306,674) |
| | | | | | | |
| **Net Surplus/(Deficit)** | **2,314,597** | **6,978,569** | **(290,044)** | **1,211,900** | **2,245,936** | **3,782,110** |
| | | | | | | |
| Prior Period Adjustment | — | — | (2,186) | — | — | — |
| | | | | | | |
| **Balance Sheet** | | | | | | |
| Cash and Investments | 6,384,705 | 12,560,375 | 13,074,533 | 14,996,008 | 17,650,862 | 20,788,350 |
| Less: Current Liabilities/Encumbered | 1,524,742 | 1,436,096 | 1,642,154 | 949,774 | 1,744,073 | 823,272 |
| **Current Position** | **4,859,963** | **11,124,279** | **11,432,379** | **14,046,234** | **15,906,789** | **19,965,078** |
| | | | | | | |
| Accounts Receivable | 513,551 | 1,291,908 | 808,106 | 351,500 | 706,510 | 837,920 |
| Due from Other Funds | 1,167,585 | 1,427,103 | 974,609 | 984,167 | 930,289 | 713,206 |
| Due from Other Governments | 398,307 | 375,009 | 553,225 | 450,801 | 588,980 | 481,810 |
| | | | | | | |
| Deferred Revenues | (263,803) | (341,747) | (424,681) | (446,595) | (626,633) | (587,115) |
| | | | | | | |
| Total Fund Balance | 7,637,897 | 14,616,466 | 14,324,236 | 15,536,136 | 17,782,072 | 21,564,182 |
| As % of Revenues | 96.5 | 107.9 | 175.0 | 176.5 | 159.0 | 173.7 |
| Unreserved/(Unassigned) Fund Balance | 2,249,074 | 13,717,732 | 13,222,879 | 10,405,256 | 13,051,711 | — |
| As % of Revenues | 28.4 | 101.3 | 161.6 | 118.2 | 116.7 | — |
| Unrestricted Fund Balance | — | — | — | — | — | 21,293,206 |
| As % of Revenues | — | — | — | — | — | 171.6 |

## Finances

### Resource-Dependent Revenue System

Alaska's economic and financial performance is tied closely to its natural resource base, with 92% of unrestricted general fund revenues derived from petroleum-related activity estimated for fiscal 2013. Fluctuating global energy prices in 2007, 2008 and 2009 led to sharp surges and drops in the state's unrestricted general fund revenues in the related fiscal years. Revenues have grown sizably since fiscal 2009 along with petroleum prices, enabling additional deposits to the state's various reserve funds. The CBR and SBR together grew to $15.9 billion in fiscal 2012 from $8.1 billion in fiscal 2009, and the fund balance of the state's permanent fund increased to $40.3 billion from $29.9 billion over the same time frame.

The state's finances are unique among its peers, given its lack of statewide personal income and sales tax, along with the presence of vast reserves that are funded through constitutional mechanisms. The bulk of the state's revenues, about 90%, derive from energy production, royalties and corporate income and property taxes. General fund (GF) revenues are considered either restricted or unrestricted. Unrestricted revenues are those that are not designated for use by the state constitution, state or federal law, trust or debt restrictions or customary practice, whereas restricted revenues comprise the balance of GF revenues and can only be used for specific purposes as outlined through one of the authorizations mentioned in the previous sentence. Most debate over the budget is centered on how to use the unrestricted portion of GF revenues.

The state uses three factors to forecast oil production revenues: price, volume and lease expenditure. While high oil prices have been a boon to the state, the volume of production is expected to continue to fall. State forecasts anticipate a 4.5% decline in production for fiscal 2013, followed by a 2.7% decline for fiscal 2014. Royalties from oil production range from 6.25%–64.1%; most royalties tend to fall at about 12% of the market value of oil, the definition of which was established by court settlement. A quarter of the royalties is reserved for the permanent fund.

In 2006, Alaska moved from taxing oil production on a gross basis to taxing it on a net basis with the implementation of Alaska's Clear and Equitable Share (ACES) act and the phasing out of the personal property tax (PPT). ACES allows the use of various deductions and credits to incentivize reinvestment in oil fields by major producers. At the same time, the state aimed to attract smaller producers to new satellite fields by sharing the risk of development and taking a portion of profits.

Debate over the effectiveness of Alaska's current oil tax structure continues, and the governor has sought to reform ACES by lowering taxes to promote investment, drilling and job creation. Opponents of his efforts maintain that there is no guarantee that enough investment can be generated to offset revenue losses. A bill that would implement the governor's proposals passed the House during the 2012 session but stalled in the Senate. The governor submitted legislation again in January 2013 that recently passed in both Alaska's Senate and the House. The governor is expected to sign the approved bill.

The state's largest expenditures are for Medicaid and education, although the payment of the permanent fund dividend, the annual payment to full-time state residents from earnings on the permanent fund's investments, is also a significant source of spending on a GAAP basis. Other forms of state spending include numerous subsidies and other forms of assistance to local governments, such as revenue sharing transfers, paying a share of school debt service, subsidizing power in rural areas, providing transportation (such as the Alaska Marine Highway and capital assistance for airstrips) and fulfilling the state's obligation to top the statutorily required pension and OPEB contributions of local units. Many of these commitments are discretionary and could be cut in the event of fiscal stress. Deposits to the permanent fund and other reserves are considered one-time spending.

It is worth noting that the state plays a relatively large role in the delivery of public services given the very long distances between population centers, the lack of development outside of major towns and transportation corridors, extreme disparities in resources among regions and the state's stewardship of significant natural resources.

## Very Large Reserve Funds

As noted above, the state has prudently set aside much of its revenue windfall in the CBR and SBR. Deposits of surplus funds as well as dedicated petroleum dispute settlement funds have brought the CBR's balance to more than $11 billion. The SBR has grown to $5.5 billion and, in addition, more than $1 billion has been set aside for prefunding school formula payments. Additional balances available to the state include the Alaska Permanent Fund's realized earnings of almost $3 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 prefunded balance for education, equal to about one year of education expense, does not require a vote of the Legislature for its use.

The available reserves are multiple times larger than the general fund if combined. Although these funds vary in their levels of accessibility, on both a statutory and political level, during multiyear periods of low oil prices and revenue shortfalls, the state has relied on these reserves to cover operating expenses.

## Permanent Fund

The permanent fund was approved constitutionally in 1977 to support the state in perpetuity after its supply of oil is exhausted. It receives 25% of royalties on mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the state. The permanent fund's principal is constitutionally protected. The fund is governed by a board of six gubernatorial appointees serving staggered terms, plus the commissioner of revenue and another cabinet member. The board enjoys considerable investment policy flexibility and maintains a broad, global portfolio that is similar to a sovereign wealth fund. The portfolio's market value declined sharply during the recent recession (to $29.9 billion in fiscal 2009 from $35.9 billion in fiscal 2008), but many of the losses went unrealized, and its value has rebounded with the economic recovery. As of Oct. 31, 2012, the fund was valued at $39.38 billion.

Earnings from the permanent fund's investments go toward an annual per-resident dividend payment established statutorily in 1980. This dividend is calculated using a formula based on 21% of statutory net earnings over the previous five years. After an inflationary-proof statutory transfer to the permanent fund reserve corpus, the remaining dividend funds can be appropriated by a simple majority of the Legislature, although they are generally left untouched. In recent years, the state has paid out a dividend between $878 and $1,300 per eligible resident; in fiscal 2011, the dividend payment was $1,174 per resident, totaling $722 million. The remaining $1.6 billion balance was left untouched.

The state's cash position is very strong given that the GF also includes the SBR and CBR balances.

## SBR

The SBR was established by the Legislature in 1990 to receive an unappropriated balance from fiscal 1991. These funds were drawn down to cover budget deficits in fiscal 1993 and 1996 and were left completely empty thereafter until a deposit of $1 billion in fiscal 2008. The SBR may be drawn by a simple majority of the Legislature if revenues are insufficient to cover expenditures or for disaster response. By statute, a maximum of 25% of the fund's balance may be drawn in a given year. The SBR is the first fund to be drawn upon in the event of a budget deficit, and its earnings flow to the GF. As of Oct. 31, 2012, the SBR's balance was $5.5 billion.

## CBR

The CBR was established in 1990 through voter initiative. It is meant to provide GF cash flow and budgetary resources during low oil price periods and is the second reserve after the SBR to be drawn upon in the event of a budget deficit. It receives deposits from settlements and litigation proceeds stemming from back taxes on oil and mineral production, leases and royalties. Draws from the CBR must be paid back eventually. If GF expenditures are less than the prior year's GF expenditures, an appropriation requires a simple majority vote of the legislature; other draws require a three-fourths majority vote. The state made draws on the CBR totaling $5.2 billion in the 1990s and early 2000s; its most recent cash flow draw occurred in fiscal 2005. The CBR has been completely reimbursed for the use of those funds.

The CBR is comprised of two accounts. The main account is responsible for covering fluctuations in the GF and thus has a very conservative investment profile, solely fixed income. As of its most recent valuation, the balance of the main account stood at $5.8 billion. In contrast, by statute, the CBR's subaccount is assumed to not be needed for five years, which allows for a higher risk investment portfolio and greater fluctuations in value.

The subaccount held $577 million at the start of 2008, and the state made a deposit of approximately $4 billion in April of that year. By fall 2008, the subaccount's value had plummeted, although it rebounded in the coming years. Valuations conducted on Sept. 30. 2010, and Sept. 30, 2011 showed the subaccount with a balance of $4.6 billion and $5 billion, respectively, and the most recent valuation placed the balance at $5.5 billion. The majority of the state's $255 million settlement in November 2012 against BP Exploration Inc. has been deposited into the CBR.

## PEF

The public education fund (PEF) began as a legislative set-aside in 2005, with the goal of building up a full year's funding for the state's public school formula in advance of the next fiscal year. The PEF may only be expended for public schools, and since funds are appropriated into the PEF, there is no appropriation required to disburse them. The fund has carried a balance of about $1.1 billion in recent years.

## Recent Financial Results

Fiscal 2012 North Slope West Coast oil prices averaged $112.65 per barrel, well over the $94.70 per barrel forecast on which the budget was based. On a GAAP basis, fiscal 2012 ended on June 30 with a $3.8 billion general fund surplus, bringing the general fund balance to $21.6 billion, which is more than two times total general fund expenditures. In addition, there was a $192.8 million net positive fund balance change in the state's permanent fund, increasing the fund to $40.3 billion. The fall 2012 forecast projects fiscal 2013 oil prices at $108.67 per barrel, down from the $110.44 per barrel on which the budget was based. The revised estimate for oil production is also slightly lagging the forecast in fiscal 2013; 0.553 barrel (bbl)/day is now anticipated, down from 0.563 bbl/day forecast.

The fall 2012 revenue forecast points to unrestricted general fund revenue in fiscal 2013, falling behind the budget due to these lagging results. Fiscal 2013 unrestricted general fund revenues are forecast at $7.57 billion, as compared with $7.7 billion in anticipated expenditures. The state maintains several options to close this modest forecast gap in addition to reducing discretionary expenditures, such as capital projects and statewide supplemental expenses.

The governor has proposed a fiscal 2014 operating budget that forecasts oil prices increasing slightly to $109.61 per barrel, with a slight decline in oil production assumed. Fiscal 2014 unrestricted general fund revenues are forecast at $7 billion, a 6.8% decline from anticipated revenues in fiscal 2013. The proposed $6.5 billion in recurring and discretionary appropriations is 14.3% less than the prior year, primarily due to a $1.1 billion proposed cut in capital expenditures. The proposal includes a $508 million transfer to the SBR. The budget proposal is being considered in the 2013 legislative session.

## Economy

### Highly Concentrated Economic Base

Although Alaska’s economy is highly concentrated in oil and gas development, the sheer abundance of the state’s natural resources allows it to maintain a viable, albeit narrow economy. There has been some diversification of late, but the economy’s main components continue to be resource extraction (32%), seafood processing (10%) and tourism (11%). Federal government employment (36%) accounts for a larger than typical share of state employment in Alaska and is a risk factor for the state, given continued uncertainty over federal deficit reduction. Less than 1% of land in the state is owned by private, nonnative owners. Native corporations control 13% of Alaska’s lands, while the state owns 26%, and the federal government 60%.

Alaska’s oil is concentrated on the North Slope and adjacent offshore areas. Gas was discovered on the North Slope in the 1940s, leading the federal government to set aside what would become the National Petroleum Reserve. Oil was discovered in 1952, and production on Cook Inlet began in 1957. The Prudhoe Bay field was discovered in 1967 and served as the location for the state’s first oil lease in 1969. Oil began flowing through the Trans-Alaska Pipeline System (TAPS) in 1977.

Natural gas remains largely unexploited in Alaska due to the high cost of developing the resource and low natural gas prices in the continental U.S. Some gas is used on site for power, but otherwise it is generally pumped back into the ground to maintain the productivity and enhance the longevity of oil fields. Prospects for future oil production are a key concern of the state, which maintains sophisticated forecasting models to monitor the potential for future output. Prudhoe Bay’s oil production peaked in the late 1980s and has sloped downward ever since.

The addition of newer, smaller oil fields in the central North Slope continues to slow the downward slope of the production curve, and this trend is likely to continue. However, it is worth noting that state revenue forecasts exclude the potential for future revenues from undiscovered natural resources, and that the state estimates that 70% of its north land remains unexplored. Research provided by the state suggests that there are additional undiscovered oil and gas reserves, some on the North Slope near existing oil infrastructure, others in the Arctic National Wildlife Refuge (ANWR), National Petroleum Reserve (NPRA) or offshore in areas such as the Chukchi Sea. Prospects for development depend on resources, prices and technology. Gold, silver and zinc deposits have also been discovered at multiple sites with multiple degrees of exploitability.

Alaska has enjoyed steady population growth. Although it ranks forty-seventh in terms of population, its average population growth has slightly outpaced that of the U.S. over the past decade. The state has a high level of internal and external migration, relatively few foreign-born residents and lower poverty compared to other states. More of its citizens graduate high school than in the average state, and Alaska is one of the youngest states demographically.

Although the state's employment numbers dipped for a brief period in late 2009, it has mostly experienced positive growth since then. Employment in natural resources is taking an increasingly larger share of the state's overall workforce, although it is linked to other sectors that have experienced employment increases, such as construction and transportation. Employment share related to trade, transportation and utilities outpaces the U.S. average, as Anchorage Airport remains the world's third-busiest cargo airport and the nation's largest, despite some cuts during the recent downturn. Its location means it is a key transportation hub between the U.S., Russia, Europe and Asia. The recession had a significant impact on visitors to the state, with air and cruise ship travel declining from 2007–2010. Data provided by the Alaska Department of Commerce show an increase in visitors by air during 2011 and a significant uptick in visitors by ship in 2012.

Alaska benefitted from recent rounds of base realignment and closure (BRAC), although current budgetary issues in the federal government and sequestration are expected to have a negative impact on the military presence in the state. Alaska is a desirable location for veterans due to its annual dividend payment, and the continued migration of military retirees to the state furthers the concentration of armed services employment in the state.

The mining industry is also present in the state due to large deposits of gold, copper, silver, coal, zinc and lead. For 2011, the cumulative value of the state's mining industry was $4.4 billion.

A historical trend of unemployment rates that ranged higher than those of the U.S., due in part to the seasonal nature of many Alaskan jobs and a high rate of internal migration, was reversed in 2009 as the national recession had a relatively modest impact on the state's economy due to booming oil prices.

The state's income and earnings are closely tied to energy price trends, with income spikes corresponding with booming energy prices, only to drop off sharply during later price depreciation. The state's quarterly personal income growth generally lags behind that of the far west region and nation, although income growth through the first half of 2012 bucked that trend. The third quarter of 2012 saw a reversal, as the state's 2.5% growth lagged the nation's 3.2% growth and the region's 3.7% growth. State personal income per capita typically exceeds that of the nation, with the state's personal income per capita of $45,665 in 2011 equal to 109.9% of the nation.

## Future Development of Resources

Fitch energy analysts anticipate that oil prices will remain strong in 2013 well above the long-term base case price of $65 per barrel. For more information, see Fitch Research on "2013 Outlook: North American Oil & Gas," dated December 13, 2012, available on Fitch's website at www.fitchratings.com. Demand is still trending above its long-term trend line, although the possibility of returning to a downturn/recession in Europe and the U.S. is a potential downside risk that would diminish demand.

The state is slowly progressing toward completing a natural gas pipeline, with increased emphasis on liquefied natural gas due to the availability of low-cost shale gas in the continental U.S. Fitch notes that despite persistently low natural gas prices, natural gas production is expected to increase due to shale gas production. The growth in supply amid tepid domestic demand is expected to keep prices weak.

There has been continued interest in bidding on leases of state land for oil and gas exploration and production. In 2011, the state issued 182 leases and received 418 bids for lease tracts on the North Slope, Cook Inlet, Alaska Peninsula and Beaufort Sea, which totaled more than $32 million. On Nov. 7, 2012, the state received 132 bids on 122 lease tracks, with winning bids totaling more than $14 million, $11.5 million of which was for lease tracks on the North Slope; this was the fourth largest by dollar amount since areawide lease sales began in 1998.

On March 29, 2012, the state reached a settlement with major producers ConocoPhillips, Exxon Mobil, BP, Chevron and Leede over the future of Point Thompson, Alaska's largest undeveloped oil and gas field. This settlement resolved seven years of litigation and requires producers to begin moving gas liquids from the fields to the TAPS by the winter of 2015−2016. The settlement is structured around granting additional acreage to the producers; the more production undertaken, the more acreage for further development is granted. If the companies are not producing liquid gas by the winter of 2015−2016, then the granted acres will be returned to the state.

Under the settlement, the producers are mandated to invest significant amounts of capital for gas development. Since Thompson contains around 25% of the North Slope's natural gas reserves, the settlement is considered by some in the state to be a major step forward in the construction of a gas pipeline, although the lengthy time frame for development and high projected costs remain concerning.

An update released in October 2012 estimated that the construction of the pipeline would require 1.7 million tons of steel, a peak workforce of 15,000, a permanent workforce of more than 1,000 and cost $45 billion−$60 billion to complete. The partnership building the pipeline includes ConocoPhillips, Exxon Mobil, BP and TransCanada. These entities are now looking for input from the state in regards to tax policy, land use and environmental regulations, and this issue is being discussed in the current legislative session. The state continues to believe in the viability of this project, although Fitch notes that project development will be a lengthy process.

## Management and Administration

Alaska's governance practices are relatively streamlined and institutionalized. The governor and the lieutenant governor are the only statewide elected officials, and he or she enjoys strong prerogatives, including line-item veto power and a three-fourths legislative majority requirement to overturn a veto. By Dec. 15 of every year, the governor must submit three annual budgets for the following fiscal year in the areas of operations, mental health and capital. Long-range revenue forecasts based on oil price, volume and reinvestment by oil companies are used in crafting the budget. These forecasts, which blend NYMEX and internal sources, are prepared at least twice a year, although they are not legally binding. The forecast excludes undiscovered resources and has assumed a significant annual shutdown each year since the North Slope Spill in 2006.

Starting in 2008, the Legislature added a 10-year expenditure planning requirement to the budget planning process, and the first plan of this kind was prepared as part of the fiscal 2010 budget. Often when the state expects to receive revenues in an amount greater than originally budgeted, it will prefund spending for the following fiscal year. During the past five fiscal years, the state forward-funded $4.9 billion toward education, municipal revenue sharing, rural power cost reduction and retirement system deposits.

Fitch credits the state for its centralized debt management under the state bond committee, which provides a yearly debt report. GO bond authorization requires voter approval, while lease appropriations and COPs merely require legislative approval. The state’s debt policy limits debt service to 8% of general fund unrestricted revenue; in fiscal 2011, the state’s debt service as a percentage of general fund unrestricted revenue stood at 2.6%. This ratio is forecast by the state to remain in the mid-2% range over the next five years.

Management exhibited a willingness to make cuts and maintain austerity during the period when oil prices were low, through the late 1990s and early 2000s. Constitutional mechanisms to fund reserves ensure that there is a nearly continuous flow into reserve funds, and the state’s political environment makes use of certain reserves, especially the permanent or earnings reserve fund, very unlikely. The state’s appropriation limit is based on inflation and population growth, and the state is well below the maximum. There are no restrictive practical limitations to revenue raising.

## Economic Trends

**Nonfarm Employment**
(000, Not Seasonally Adjusted)

| | Alaska | % Change | U.S. | % Change |
|---|---|---|---|---|
| 1998 | 274.0 | 2.4 | 125,930 | 2.6 |
| 1999 | 278.1 | 1.5 | 128,993 | 2.4 |
| 2000 | 283.1 | 1.8 | 131,785 | 2.2 |
| 2001 | 288.3 | 1.8 | 131,826 | 0.0 |
| 2002 | 293.8 | 1.9 | 130,341 | (1.1) |
| 2003 | 298.2 | 1.5 | 130,100 | (0.2) |
| 2004 | 303.3 | 1.7 | 131,509 | 1.1 |
| 2005 | 308.8 | 1.8 | 133,747 | 1.7 |
| 2006 | 313.9 | 1.7 | 136,125 | 1.8 |
| 2007 | 316.9 | 1.0 | 137,645 | 1.1 |
| 2008 | 321.1 | 1.3 | 136,852 | (0.6) |
| 2009 | 319.9 | (0.4) | 130,876 | (4.4) |
| 2010 | 324.1 | 1.3 | 129,917 | (0.7) |
| 2011 | 329.5 | 1.7 | 131,497 | 1.2 |
| 2012 | 334.1 | 1.4 | 133,739 | 1.7 |
| February 2012 | 319.4 | — | 131,604 | — |
| February 2013p | 320.6 | 0.4 | 133,603 | 1.5 |

**Unemployment Rates**
(%, Not Seasonally Adjusted Annual Rates)

| | Alaska | U.S. | State as % of U.S. |
|---|---|---|---|
| 1998 | 6.1 | 4.5 | 136 |
| 1999 | 6.2 | 4.2 | 148 |
| 2000 | 6.2 | 4.0 | 155 |
| 2001 | 6.2 | 4.7 | 132 |
| 2002 | 7.1 | 5.8 | 122 |
| 2003 | 7.7 | 6.0 | 128 |
| 2004 | 7.4 | 5.5 | 135 |
| 2005 | 6.9 | 5.1 | 135 |
| 2006 | 6.5 | 4.6 | 141 |
| 2007 | 6.1 | 4.6 | 133 |
| 2008 | 6.4 | 5.8 | 110 |
| 2009 | 7.7 | 9.3 | 83 |
| 2010 | 8.0 | 9.6 | 83 |
| 2011 | 7.6 | 8.9 | 85 |
| 2012 | 7.0 | 8.1 | 86 |
| February 2012 | 7.1 | 8.3 | 86 |
| February 2013p | 6.5 | 7.7 | 84 |

**Personal Income**
(Change from Prior Year)

| | % Change | | |
|---|---|---|---|
| | Alaska | U.S. | State Growth as % of U.S. |
| 2000 | 7.4 | 8.2 | 91 |
| 2001 | 6.7 | 3.8 | 176 |
| 2002 | 4.3 | 2.0 | 216 |
| 2003 | 2.4 | 3.5 | 70 |
| 2004 | 5.7 | 6.0 | 96 |
| 2005 | 6.7 | 5.5 | 121 |
| 2006 | 6.9 | 7.4 | 92 |
| 2007 | 6.9 | 5.7 | 120 |
| 2008 | 9.6 | 4.6 | 208 |
| 2009 | (3.1) | (4.8) | 65 |
| 2010 | 4.7 | 3.8 | 121 |
| 2011p | 5.6 | 5.2 | 108 |

**Personal Income Per Capita**
(Change from Prior Year)

| | % Change | | |
|---|---|---|---|
| | Alaska | U.S. | State Growth as % of U.S. |
| 2000 | 6.9 | 7.0 | 98 |
| 2001 | 5.7 | 2.8 | 207 |
| 2002 | 2.9 | 1.0 | 275 |
| 2003 | 1.5 | 2.6 | 56 |
| 2004 | 4.0 | 5.0 | 79 |
| 2005 | 5.5 | 4.6 | 120 |
| 2006 | 5.5 | 6.4 | 86 |
| 2007 | 6.1 | 4.7 | 129 |
| 2008 | 8.5 | 3.6 | 232 |
| 2009 | (4.7) | (5.6) | 83 |
| 2010 | 2.4 | 3.0 | 81 |
| 2011p | 4.4 | 4.4 | 99 |

**Components of Personal Income: Earnings**
(%)

| | Alaska | | | U.S. | | |
|---|---|---|---|---|---|---|
| | 2002 | 2011 | % Change | 2002 | 2011 | % Change |
| Mining | 6.4 | 8.1 | 93 | 0.8 | 0.8 | 49 |
| Construction | 8.6 | 7.3 | 31 | 6.7 | 10.1 | 103 |
| Manufacturing | 2.9 | 2.7 | 43 | 12.8 | 6.4 | (32) |
| Durable Goods Manufacturing | N.A. | 0.5 | N.A. | 8.2 | 5.1 | (16) |
| Trade, Transportation and Utilities | 16.3 | 14.2 | 34 | 16.5 | 22.4 | 83 |
| Financial Activities | 5.0 | 5.0 | 52 | 9.7 | 11.7 | 63 |
| Professional and Business Services | 8.6 | 9.5 | 70 | 14.6 | 8.1 | (25) |
| Education and Health Services | 9.2 | 10.7 | 79 | 10.7 | 29.0 | 266 |
| Government and Government Enterprises | 30.7 | 32.5 | 62 | 16.3 | 17.8 | 47 |
| Total Nonfarm Earnings | — | — | 53 | — | — | 35 |

State population: 626,932 (2000 Census), 710,231 (2010 Census).
Population change 1990–2000: U.S. 13.2%, Alaska 14%; 2000–2010: U.S. 9.7%, Alaska 13.3%.
Personal income per capita 2009: $45,665, 110% of U.S., rank 10.
P – Preliminary. N.A. – Not applicable. Note: Monthly unemployment rates are seasonally adjusted.

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