

## **FITCH RATES ALASKA MUNICIPAL BOND BANK AUTHORITY'S \$42MM GOS 'AA'; RATING WATCH NEGATIVE**

Fitch Ratings-New York-23 May 2016: Fitch Ratings has assigned a 'AA' rating to approximately \$42.435 million of Alaska Municipal Bond Bank Authority (MBBA; bond bank) general obligation (GO) and refunding bonds, 2016 series two, issued under the bond bank's 2016 GO bond resolution. The rating is on Rating Watch Negative (RWN), which is expected to be resolved with the state's enactment of a budget for fiscal 2017.

The bonds are expected to sell via negotiation on May 24, 2016.

### **SECURITY**

The bonds are general obligations of the bond bank, for which the state will maintain a standing appropriation of state general fund resources to replenish the bonds' reserve fund in the event of borrower default.

### **KEY RATING DRIVERS**

**MULTIPLE LAYERS OF SECURITY SUPPORT NEW PROGRAM:** The MBBA's obligations under the 2016 resolution are supported by multiple levels of bond bank and state support. Foremost among these is the state's inclusion as part of its annual debt service appropriation, an appropriation for reserve fund replenishment in the event of a draw related to default by a participating regional health care organization (borrower or RHO). Other security provisions include the state's statutory moral obligation, borrower reserve funds, and access to unrestricted assets of the bond bank held in the custodian account.

**PROVEN STATE SUPPORT AND STRONG REPAYMENT HISTORY:** The bond bank's programs have a solid history of debt repayment, and the state of Alaska has a demonstrated history of support for and involvement with the bond bank. The bond bank has consistently worked with the state to strengthen bondholder protections while achieving its programmatic goals. The state's own resources are substantial.

**EXPECTED USE OF SURETY POLICIES FOR BOND BANK RESERVE FUND:** The expected use of surety policies for the debt service reserve fund requirement weakens the link between the standing appropriation to replenish the reserve fund and could require draws upon other funds if the surety provider does not perform. This results in a two-notch distinction from the state's 'AAA' IDR.

**RATING WATCH NEGATIVE:** Bonds linked to the Issuer Default Rating (IDR) of the state of Alaska were placed on RWN on Feb. 29, 2016, reflecting uncertainty in both the execution and impact of budget initiatives to solve for significant budget gaps due to the severe, global decline in crude oil prices.

### **RATING SENSITIVITIES**

The rating is sensitive to the strong continued oversight of the MBBA and the maintenance of the custodial account. The rating is also sensitive to movement in the state of Alaska's GO bond rating to which it is linked. Fitch will resolve the Negative Watch after analyzing the state's enacted budget for fiscal 2017, which begins on July 1.

## CREDIT PROFILE

The 'AA' rating is based on the state's commitment to maintain a standing appropriation of general funds for program reserve fund replenishment.

## STRONG BOND BANK SECURITY PROVISIONS

GO bonds issued under the 2016 resolution will incorporate multiple layers of security on both the borrower level and state level. Issuance requires a borrower's revenue pledge and the bond bank has typically required a borrower reserve for revenue bonds. RHOs must demonstrate project essentiality and ability to repay in order to access financing, and additionally, amendments to the bond bank act require that there is a direct financial benefit to the state and there is an increase in the regional quality of care for financing the capital improvement.

A program reserve fund is backed by a moral obligation of the state established by state statute requiring establishment of a reserve and requiring that the bond bank seek a general fund appropriation in the event of a borrower's payment default. This pledge is strengthened by the bond bank's commitment to seek a standing appropriation for these bonds and the state's consistent practice of including this appropriation in all enacted budgets since 2009. The enacted budget for fiscal 2016 and governor's executive budget for fiscal 2017 include this appropriation.

The bond bank's program reserve fund for the 2016 resolution bonds is set at either maximum annual debt service, 10% of par, or average annual debt service. This reserve fund will be separate and apart from reserves established under the 2005 and the 2010 bond resolutions (rated 'AA+' and 'AA', respectively). Surety policies are permitted under the resolution and the bond bank has indicated a strong interest in this option to fund the reserve requirement. Failure of a surety could lead to insufficient time for the state to make the appropriation for debt service. However, in advance of a required state appropriation, the bond bank could access other resources, such as the custodian account, to cover debt service payments, although they are not specifically pledged to bondholders. Fitch believes that procedures for notification of borrower delinquencies that occur well in advance of debt service payments and strong bond bank oversight largely offset this concern.

The custodian account, bolstered by recent state deposits, prior reserve releases, and funded at approximately \$11 million according to the bond bank, is expected to be maintained at this approximate level in future years, although direct loans by the bond bank and deposits to reserve funds may diminish the custodian account balance. The bond bank reports a policy goal of maintaining a minimum of \$5 million in this account.

## BROADENING OF BOND BANK SCOPE

The bond bank was established in 1975 to provide access to low-cost capital financing for Alaska local governments. The bond bank's limit for total bonds outstanding at any one time is almost \$1.8 billion; including the current sale, total bonds and obligations outstanding is expected to be just over \$1 billion, inclusive of debt issued under the 2005 and 2010 bond resolutions. Under the 2016 bond resolution, up to \$205 million in project funding for RHOs is permitted.

The current bonds will provide funding to the Tanana Chiefs Conference (TCC) to refinance outstanding bonds issued by the city of Koyukuk on behalf of TCC for the construction of a regional health center adjacent to the Fairbanks Hospital. The project was developed in partnership with the federal Indian Health Services (IHS) through a joint venture construction project agreement. As part of the agreement, IHS provides the initial equipment necessary to operate the health center and then provides funding for supplies and staffing for the operation and maintenance

of the center. The current agreement extends through August 2030 and the current bond issue is scheduled to mature in 2024.

Senate bill 46 was enacted in the 2015 legislative session and permits the issuance of bonds or notes by the bond bank for a RHO, as well as for state joint action agencies. This approval followed authorization for borrowing by the University of Alaska in 2014; in all cases, broadening the original scope of the bond bank's role for financing local government capital projects. In addition to the debt issuance cap for RHOs, the bond bank may not finance more than 49% of project costs, the remaining costs of the project must be secured prior to the bond authority provides financing, and the bond bank bonds may not exceed \$102.5 million for any single project. For the current issue, TCC is contributing \$40 million from cash on hand.

There are 32 RHOs located in the state of Alaska that provide the majority of health care services to Native Alaskans; accounting for over 20% of the residents in the state. Key revenue sources for the RHOs are IHS, Medicaid and Children's Health Insurance (CHIP), private health insurance, federal department of health and human services (DHHS) and state DHHS grants, and Medicare. IHS provides the majority of revenue to the RHOs at 63% of the total, followed by Medicaid and CHIP at 15%. The federal government's responsibility to provide health care to Native Americans is a trust obligation and IHS is not allowed to reduce funding for programs unless the U.S. Congress reduces appropriations.

## STRONG BORROWER SECURITY PROVISIONS

In addition to security provisions offered by the bond bank itself, the bond bank establishes additional borrower security provisions to ensure full and timely repayment of its loans. For the current issue, the RHO will establish a borrower reserve fund, provide a gross pledge of revenues to the bond bank, and maintain a lock box for the receipt of daily pledged revenues that are deposited with the trustee for the bonds on a monthly basis. Additional borrower covenants include the maintenance of debt service coverage ratios, an additional bonds test, and a requirement for days cash on hand.

## ALASKA'S RESOURCE-DEPENDENT REVENUE SYSTEM

Alaska's 'AAA' GO rating reflects the state's maintenance of very substantial reserve balances and conservative financial management practices to offset significant revenue volatility linked to oil production from the North Slope and global petroleum price trends. For many years, the state focused on expected declines in production at its oil fields, prudently dedicating a substantial share of its past oil tax revenue to reserves to ease anticipated revenue loss due to the declines. However, the steep drop in crude oil prices beginning in late 2014 exceeded expectations and significantly reduced tax revenues to the state, requiring sizable use of reserves to fund operations in fiscals 2015 and 2016.

For the fiscal year that began on July 1, 2015, the state's budget planned for a \$2.7 billion draw on reserves to fund operations; Fitch expects the draw will increase to about \$4 billion due to weaker than expected crude oil prices since the budget was enacted. The 2016 spring forecast expects low crude oil prices to continue into fiscal 2017.

The governor's recommended budget for fiscal 2017 continues to be debated in the current legislative session. The governor's budget seeks to fundamentally change the way in which the state finances operations and attempts to shift volatility in the natural resource sector to the state's permanent fund and permanent fund earnings reserve from the unrestricted general fund.

For further information on the state, please see 'Fitch Places State of Alaska on Negative Watch; Rates GO Bonds 'AAA' dated Feb. 29, 2016, available at '[www.fitchratings.com](http://www.fitchratings.com)'.

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Applicable Criteria

U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)

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