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Summary:

Alaska Municipal Bond Bank Alaska; Appropriations

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Credit Profile		
US$37.0 mil GO bnds (Alaska) 2017 ser TWO (AMT) due 05/01/2043		
Long Term Rating	AA/Negative	New
US$12.5 mil GO bnds (Alaska) 2017 ser ONE due 05/01/2037		
Long Term Rating	AA/Negative	New

Rationale

S&P Global Ratings assigned its 'AA' rating to Alaska Municipal Bond Bank's (AMBB) $49.5 million in master resolution general obligation (GO) bonds, series 2017 One and Two. The bond bank is a public corporation of, and benefits from certain credit support by, the state of Alaska. The outlook is negative.

The negative outlook reflects our view of the large structural budget deficit in Alaska's unrestricted general fund. Currently, the state is able to finance its operating deficits by withdrawing funds from its budgetary reserves. The governor has proposed a number of reforms for the fiscal 2018 budget that is under review by the legislature. If none of the governor's proposed reforms are adopted and spending is maintained at levels higher than fiscal 2017, fiscal projections from the Office of Management and Budget (OMB) show reserves could be depleted by the end of fiscal 2022. The projections include a full dividend payment, while the governor vetoed half of the 2016 dividend distribution. Therefore, without structural fiscal reform in the 2017 legislative session, we would likely lower our ratings on the state debt.

The rating reflects our view of:

- The state's underlying general creditworthiness ('AA+/Negative' GO rating), and
- A resolution provision to annually seek an appropriation to replenish the debt service reserve (DSR) to its required level in the event it is drawn on.

Our rating reflects the strength of the appropriation pledge and the legislature's demonstrated commitment to include the appropriation in the state's annual operating budget. However, the bonds are general obligations of the AMBB, payable from sources pledged under the 2005 master resolution, which assigns borrower payments to the trustee for the repayment of the bonds.

The series 2017 One and Two bonds are the 38th and 39th series to be issued under the AMBB's 2005 master bond resolution, which includes the annual standing appropriation feature that we view as integral to the strength of the bond program. Each year, the AMBB is required to submit a budget request to the state for an appropriation to replenish the DSR to its defined level if there is a draw because of borrower default. We have confirmed that the DSR balance required under the resolution is greater than any individual semiannual debt service payment. As it has each year since 2009, the legislature included and the governor signed, in fiscal 2017, within the enacted operating budget, an open-ended appropriation to AMBB's reserve in the event of a borrower default. The fiscal 2018 budget under negotiation also includes the appropriation. On its enactment, the fiscal 2018 budget would represent the tenth consecutive year the standing appropriation has been included in the state's operating budget to replenish the reserve should it be used and brought below the required level. In recent years, the legislature has also appropriated any excess AMBB earnings to the AMBB rather than transfer the funds to the state's general fund as otherwise required by statute.

We understand that, in practice, AMBB requires borrower loan payments be made seven business days in advance of bond debt service, and in the event of a default by the borrower(s), it would coordinate with state administrative staff to implement the appropriation and would draw on the DSR as debt service was due, which would immediately be replenished by the state. And because the debt repayments by local governments occur on a rolling basis throughout the year, the standing appropriation allows the AMBB to replenish and to maintain the DSR balance at its required level. Related to this credit strength, in our view, is the diversity of the pool provided by the 37 borrowers under the 2005 bond bank program.

In addition to the appropriation, AMBB also has additional statutory authority to borrow funds from Alaska's general fund at the discretion of the commissioner of the Department of Revenue (DOR).

Series 2017 One proceeds provide new-money loans to Kenai Peninsula Borough (KPB) for Kenai Peninsula South Hospital ($4.8 million), KPB solid waste improvements ($6 million), and Seward road improvements ($3 million). The series 2017 Two proceeds provide new-money loans for port improvements to Unalaska ($35 million) and for small boat harbor improvements to Whittier ($2 million), both of which are subject to the alternative minimum tax.

No additional reserve deposit will be required for the 2017 One and Two bonds as existing assets in the 2005 Resolution reserve fund (including cash and DSR sureties) exceed the post-2017 One and Two requirement, which, according to the 2005 resolution, is required to equal the lowest of 10% of the principal amount of bonds outstanding, 125% of average annual debt service on all the bonds outstanding, or maximum annual debt service (MADS). The bonds are general obligations of the AMBB, which receives revenue from a pool of loans to municipalities and investment earnings on assets. According to the bond bank, as of Feb. 28, 2017, the 2005 reserve fund requirement was approximately $60.9 million. The bond bank has an amount sufficient ($66.5 million) to satisfy the reserve fund requirement, consisting of the following:

- $36.6 million in funds contributed from the custodian account (the custodian account, which had a balance of $11 million [unaudited] as of Feb. 28, 2017, is where AMBB holds retained earnings, current-year investment earnings), or unrestricted funds appropriated to AMBB by the state);
- $11 million in reserve obligation proceeds of AMBB; and
- $18 million from a surety policy provided by National Public Finance Guarantee.

In addition to the appropriation support, the bonds are backed by Alaska's moral obligation pledge to maintain a DSR for the bank's bonds and by state aid withholding provisions that, since June 1988, have applied to both GO and revenue bonds issued by the bank. The 2005 resolution establishes a common reserve fund to comply with a state statute requiring a reserve fund for any bond bank bond issues. Per state statute, on or before Jan. 30 of each year, the bond bank is required to deliver a statement to the governor and state legislature stating the amount, if any, necessary to replenish the reserve fund. If a draw on the reserve fund were to occur, the state legislature might--but is not required to--appropriate funds to replenish it to the required amount. However, we view this provision as having been strengthened by the state's standing appropriation to backfill the DSR in the event of a draw due to a borrower default.

In the event of a borrower default on a loan payment, the 2005 master resolution permits the AMBB to pursue an intercept of any grant aid from the state to the borrower. The grant intercept provision further strengthens the bonds' credit quality, in our view. The AMBB tracks the amount of state grants subject to intercept relative to the annual loan payment due by each borrower.

For more information on the state GO rating, see the full analysis on the Alaska Municipal Bond Bank, published Feb. 14, 2017, on RatingsDirect.

Outlook

The negative outlook reflects our view of the large structural budget deficit in Alaska's unrestricted general fund. Currently, the state can finance its operating deficits by withdrawing funds from its budgetary reserves. Alaska had built up large budget reserves that thus far have shielded its credit quality from the degradation that the large deficits would inflict on that of most states. But the magnitude of the fiscal deficits, even with the governor's vetoes for fiscal 2017, makes the arrangement unsustainable and, unless corrected, inconsistent with the current rating. Given their current trajectory, the state's deficit financial operations would eventually deplete its budget reserves. Therefore, without structural fiscal reform in the 2017 legislative session, we would likely lower the state debt ratings.

If lawmakers succeed in putting the state on what we view as a clear path to a sustainable fiscal structure, with its strong reserve balances intact, we could revise the outlook to stable.