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

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Credit Profile		
US$98.53 mil master resolution GO bnds (Alaska) ser 2017A due 10/01/2046		
Long Term Rating	AA/Negative	New
Alaska GO		
Unenhanced Rating	AA+(SPUR)/Negative	Affirmed
Alaska Mun Bnd Bank, Alaska		
Alaska		
Alaska Mun Bnd Bank GO		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' rating to Alaska Municipal Bond Bank's (AMBB) $102.5 million in master resolution general obligation (GO) bonds, series 2017 A. The bond bank is a public corporation of, and benefits from certain credit support by, the state of Alaska. In addition, we affirmed our 'AA+' long-term rating on the state's GO debt, our 'AA' long-term rating and underlying rating (SPUR) on AMBB's existing debt, and our 'A+' rating on the state's moral obligation debt. The outlook on all the ratings 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 the state debt ratings.

The rating reflect 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 2016 master resolution, which assigns borrower payments to the trustee for the repayment of the bonds. The borrower is the Yukon-Kuskokwim Health Corp. (YKHC), a regional health organization (RHO).

The series 2017 A bonds are the second to be issued under the AMBB's 2016 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. (It would simultaneously pursue a remedy to the default through its authority to intercept grant payments to the borrowing RHO as provided for in the resolution.)

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).

During the 2015 legislative session, the state legislature approved the issuance of up to $205 million in bonds to fund loans to 13 RHOs. Per state statute, RHOs are nonprofit corporations or home-rule boroughs that provide health aid services under a contract with the Alaska Native Health Service in a rural area that is at least 4,000 square miles. Pursuant to Senate Bill 46, AMBB is only allowed to make loans to an RHO insofar as the commissioner of the state's Department of Health And Social Services anticipates that the loan would improve the quality of care while reducing costs to the state. For example, providing care locally to patients in rural locations could reduce transportation- and lodging-related expenses, a portion of which would otherwise fall to the state. AMBB participation in RHO financings is limited to no more than 49% of a project's cost, where the balance of project funding is secured and no more than $102.5 million per project.

The series 2017 A bonds are the second series of bonds issued under the 2016 master bond resolution. Following this issuance, the AMBB will have $62.3 million of remaining bonding capacity for RHOs. The bond bank's 2005 resolution will remain the primarily lending vehicle with approximately $575 million in additional bonding capacity.

Proceeds from the series 2017 A bonds will fund a loan to the YKHC from the AMBB. Loan proceeds together with a cash contribution from the YKHC will be used, along with additional financing, to make a loan to the YKHC to build a new primary-care clinic, remodel the existing hospital in Bethel, and build staff housing. The YKHC has pledged its health care revenues to the repayment of its loan to the AMBB. The YKHC's health care revenue comprise Medicare, Medicaid, private insurance, managed-care plan-related revenues, and direct pay. Health care revenues are deposited daily into an account held by the trustee, which will withhold on a monthly basis one-sixth of the ensuing semiannual debt service payment.

The bond bank plans to use a combination of cash funding and either reserve obligation proceeds or a surety policy to fund the DSR requirement, which, according to the 2016 master 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).

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 2016 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 2016 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.

The fiscal year 2018 landscape looks broadly similar to the situation last year. With assumed oil prices of $54/bbl, the state is looking at a structural gap between its unrestricted revenues and general fund expenditures of about $3 billion. The difference is that another year has passed and, as Gov. Bill Walker's budget documents point out, there is a cost to delay. The DOR estimates that $200 million of revenue generator potential from reserves was lost because lawmakers were unable to reach agreement on a structural solution for fiscal 2017.

The main features of the governor's plan this year include the use of about $1.8 billion in permanent fund investment earnings to supplement the state's unrestricted (mostly oil-related) revenues of $1.6 billion. The governor's plan would also hold the permanent fund dividend (PFD) paid to state residents at $1,000, partially linking the payment to oil royalties rather than solely to permanent fund earnings. Proposed legislation included with the governor's budget would also triple the state's motor fuel tax with the revenue flowing to a newly created transportation maintenance fund. But even if the legislature adopted these actions, there is still a roughly $900 million gap in the governor's budget, covered by a draw on the state's constitutional budget reserve. The governor indicates that a broad-based tax, such as an income or sales tax, is likely going to be necessary. For now, the governor has highlighted this but has held off on a specific recommendation, deferring to the legislature to see what kind of approach it can endorse.

In any event, we expect the current legislative session to be important to our view of the state's credit quality. In our view, it's notable that notwithstanding the state's very real fiscal pressures, its combined permanent fund earnings reserve (PFER) and constitutional budget reserve (CBRF)--its two main budget reserves--remain equal to more than

300% of budgeted spending, both in fiscal 2017 and under the governor's fiscal 2018 budget proposal. The state's fiscal trajectory deteriorates quickly, however, if lawmakers can't reach agreement on changes to the state's fiscal structure. If none of the governor's proposed reforms are adopted, fiscal projections from the OMB show reserves could be depleted by the end of fiscal 2022 with a reversion to full dividend distribution. On the other hand, OMB's projections indicate reserves could remain at approximately $14.4 billion--roughly 300% of annual general fund expenditures--if the governor's proposals were adopted.

Absent fiscal reform, the state's unrestricted revenue, which is largely a function of oil prices and production, remains the key determinant of its budgetary condition. If oil prices match the governor's assumed $54/bbl in fiscal 2018, the $1.6 billion in unrestricted revenue implies a roughly $3 billion structural deficit. But if prices are lower—at $40/bbl, for instance—the gap widens to $3.5 billion. We estimate that under the state's current fiscal arrangements, oil prices would need to average between $100/bbl and $110/bbl to finance the governor's proposed $4.3 billion in general fund expenditures.

Based on the analytic factors we evaluate for states, on a four-point scale in which '1' is the strongest, S&P Global Ratings has assigned a composite score of '1.8' to Alaska.

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 the state's credit quality from the degradation that the large deficits would inflict on most states' credit quality. 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.

Budget Condition As Of Fiscal 2017

General purpose unrestricted revenues in fiscal year 2016 were $1.5 billion, compared to $2.3 billion in fiscal year 2015, with the reduction primarily reflecting a $43.18 average price of oil per barrel for fiscal year 2016 (a $29.40 decrease in the average price per barrel from $72.58 in fiscal year 2015). The fall 2016 "Revenue Sources Book" includes the state's forecast for a modest recovery in the price of oil ($46.81 for fiscal year 2017 and $54.00 for fiscal year 2018) and general purpose unrestricted revenues of $1.4 billion for fiscal year 2017 and $1.6 billion for fiscal year 2018.

Unrelated to the state's current fiscal pressures, the state has not yet released its Comprehensive Annual Financial Report (CAFR) for fiscal year 2016 or met its statutory requirement to post the CAFR by the Dec. 15, 2016. The delay in the release of the 2016 CAFR is due to the transition to a new accounting system. The state anticipates that the CAFR may be released by March 31, 2017. In our opinion, the delay of the report does not affect our view of management conditions.

General fund spending has declined over the past several years. At $4.4 billion in fiscal 2017, general fund appropriations are 45% below what they were in fiscal 2013. The $3.2 billion structural budget gap reflects that through the same years, unrestricted revenue has fallen by an even more precipitous 85%.

Under its fiscal 2017 budget, Alaska currently projects that it will end the year with $10.8 billion in short-term reserves, comprising $3.3 billion in its constitutional congressional budget reserve and $7.5 billion in its PFER. The Alaska OMB multiyear forecast shows that absent fiscal reform, the state's budget reserves could decline to $1.5 billion (34% of expenditures) by fiscal 2021. Reserves could outlast the projections even in a status quo scenario, however, if the governor were to veto portions of the annual PFD payments as he did for fiscal 2017.

Our view of the state's credit quality acknowledges that, in addition to its $1.2 billion in unrestricted general fund revenue, another $3.1 billion of revenue is subject to appropriation in fiscal 2017. As a matter of custom, the state has traditionally refrained from using this revenue--primarily investment income from the Alaska Permanent Fund--to pay for general fund appropriations. Instead, lawmakers have used portions of the investment income revenue to pay the state's annual PFD to state residents and to protect the permanent fund from inflation. The balance of the investment income revenue has been retained in the PFER. Consequently, the state's budget reserve balances have typically declined by less than the general fund operating deficits.

Alaska's legislature did not approve the fiscal reforms sought by Governor Walker as part of the 2017 budget process. Nevertheless, from a fiscal standpoint, the state may achieve results similar to what it might have if the reforms had been approved because the governor vetoed $1.29 billion in spending. With reduced spending, the budget shows the state drawing $3.2 billion from its budget reserves this year--the same amount as under the governor's original December 2015 reform proposal. In the absence of the vetoes, which included halving the PFD paid to state residents, the state's fiscal gap and related draw on its reserves would have approached $4.5 billion.

In our view, it's notable that notwithstanding the state's very real fiscal pressures, its combined PFER and constitutional budget reserve (its two main budget reserves) remain equal to more than 300% of budgeted spending, both in fiscal 2017 and under the governor's fiscal 2018 budget proposal.

Financial Management

Financial management assessment (FMA): Good

We consider Alaska's formal management practices "good" under our FMA methodology. An FMA of "good" indicates our view that the state maintains many best practices we consider critical to supporting credit quality, particularly in the finance department. These practices, however, may not be institutionalized or formalized in policy, may lack detail or long-term elements, or may have little recognition by decision-makers outside of the finance department.

The state has a statutory budget reserve in its general fund that, although not always funded, is available to provide liquidity. In addition, it has established the CBRF, which voters approved. Funds may be appropriated for certain purposes by a vote of three-fourths of each house of the legislature, but money can be used for interfund borrowing for general fund expenditures. All appropriations from the fund are recorded as a general fund liability. Per the state's constitution, this fund receives all oil and gas tax dispute settlements.

Until recently, the state's forecast of its leading predictor of state revenue, the price per barrel of oil, has tended to err on the low side. (This changed in fiscal in fiscal 2015 following the unanticipated collapse in global commodity prices.) The state also forecasts production and has recently enhanced its methodology on this front. Budget amendments can occur throughout the year.

Alaska produces detailed revenue forecasts, with the focus being the price of oil, which--unless the governor's reform package is adopted--remains the leading determinant of general fund revenue. Other revenue sources are also included in the revenue source book, which is released twice each year. The tax division of the Alaska DOR prepares the book, using numerous outside sources of information to help predict the price of oil.

In addition to the revenue forecast, the OMB maintains a 10-year fiscal forecast, which is updated annually. Expenditure projections are less detailed, although the state accounts for some inflationary and caseload pressures on spending levels.

The state's debt management policy is updated annually with the public debt report and debt affordability analysis as required by statute. The debt report describes the different types of debt that Alaska issues, mainly certificates of participation and GO bonds. For general fund-supported bonds, the state has a debt capacity that it determines, by policy, to be 8% of unrestricted revenue.

Investment management is also covered by the investment policy statement, and the performance of the state's investment portfolio is monitored daily. Each year the portfolio undergoes a fiduciary audit, which includes a review of legal and administrative constraints for each invested fund. The audit policy's stated goal is to keep Alaska's investment process intact during periods of market upheaval.

Alaska enacts an annual capital budget. Expenditure assumptions for the state's operating budget are adjusted as appropriate when capital projects begin. A transportation agency capital plan provides an annually prioritized plan detailing three years of projects and funding sources.

Budget management framework

The DOR issues formal revenue forecasts twice a year, in the spring and fall. The forecast is based on consultation with an engineering firm and the state department of natural resources. As noted above, the methodology for forecasting oil production has been revised to incorporate the greater variability associated with production forecasts from some oil fields that are still under development or are in the evaluation phase of development. The net effect of these changes has been to increase the long-term rate of production decline. The revenue forecast has historically been used as presented for budget adoption and not been adjusted during the budget-adoption process.

Historically, Alaska has used existing high fund balances to carry deficits and is not legally required to make midyear budget adjustments if a midyear gap develops. The governor has the discretion to hold back spending in the middle of the fiscal year if a budget gap appears to be developing. Such adjustments were last made in fiscal 2009, during oil price fluctuations. The governor can unilaterally prioritize such holdbacks, but the holdbacks have no formal requirement or schedule. Since oil prices and the state's oil-related revenues collapsed in mid-2015, the state's lawmakers have stopped short of approving comprehensive fiscal reforms. To date, they have responded by reducing general fund expenditures.

Debt And Liability Profile

As noted earlier, the state has not completed its June 30, 2016 CAFR. Total tax-supported debt per capita is $1,393 (as of fiscal 2015 audited financial and population figures) and tax-supported debt (GO and appropriation) to personal income at 2.5%. Tax-supported debt service as a percentage of general fund spending was low, at about 0.8%, in fiscal 2015. When including the local municipal school and capital reimbursement-related debt paid by the state on behalf of local jurisdictions, debt service is 1.6% of expenditures. The state's debt principal amortizing in 10 years is 47%.

At June 30, 2016 (per the state's debt report), the state had about $834.8 million of GO debt, but about $11.6 million of this is considered self-supporting veterans' mortgage revenue-secured debt, leaving about $823.2 million in net tax-supported GO debt. At the end of fiscal 2016, Alaska also had about $255.6 million of annual appropriation-supported debt.

Pension And Other Postemployment (OPEB) Liabilities

In 2006, Alaska moved all new employees to a defined-contribution retirement plan from a defined-benefit plan, but employees hired before that continue under the state's defined-benefit pension plan. In addition, unlike those of most other states, Alaska's OPEBs are constitutionally protected. Also unlike most states, however, the state has an OPEB trust fund and a track record of funding the liability on an actuarial basis. Thanks to a large, extraordinary $3 billion contribution from the state's CBRF to its pension systems, its funded ratios--for both its defined-benefit pension and OPEB liabilities--improved markedly in fiscal 2015. The contribution was split between the Public Employees' Retirement System (PERS; $1 billion) and the Teachers' Retirement System (TRS; $2 billion). Following the increased contributions, PERS and TRS actuarial funding ratios as of June 30, 2015, were 78.3% and 83.3%, respectively. However, these funding ratios combine pension and OPEB reporting.

Based on the plan June 30, 2016 CAFRs and GASB 67 reporting requirements for pension plans only, the Alaska PERS multiemployer plan had a 60% funded ratio at June 30, 2016, down from 64% the prior year. We estimate that, as of fiscal 2016, the state's proportionate net pension liability related to PERS is $5.6 billion. The separate TRS had a 68% pension-funded ratio as of fiscal 2016, down from a 74% ratio in fiscal 2015. Both PERS and TRS employ an 8.0% assumed rate of return on invested assets.

Combined with the liabilities associated with much smaller pension systems for judicial officials and retired National Guard and naval militia members, the total PERS and TRS net pension liability was $6.35 billion as of June 30, 2016. The net pension liability on this basis remains high, in our view, at $8,599 per capita and 15.3% of total state personal income.

Annual employer contributions to PERS and TRS have been set at 22% for PERS and 12.56% for TRS. However, on July 1 of each year or as soon as funds are available thereafter, the state is required by statute to contribute sufficient additional funds to bring the total pension contribution for the prior fiscal year to the actuarially determined level, which we view favorably.

The OPEB liability also includes those of other participating local governments. The state is required by statute to fund the annual contributions to the pension system at the actuarially recommended level.

In addition to the state's direct debt, since 1970, Alaska has supported the bonds issued by prequalified school districts, with the legislature able to reimburse municipalities for 60% to 100% of debt service costs. The actual program funding depends on annual legislative appropriations, and although not contractually obligated to do so, Alaska has always made the payments. We note the state debt service reimbursement program for school districts has been suspended Jan. 1, 2015 through Jan. 1, 2020.

The state also has about $1.2 billion of self-supporting state moral obligation debt issued by the AMBB, the Alaska Energy Authority, and the Alaska Student Loan Corp. Our rating on the AMBB debt recognizes features we view as strengthening related to its 2005, 2010, and 2016 resolution requiring an annual open-ended appropriation to backfill the reserve, if necessary.

Ratings Detail (As Of February 14, 2017)		
Alaska approp		
Long Term Rating	AA/Negative	Affirmed
Alaska GO		
Long Term Rating	AA+/Negative	Affirmed
Alaska GO		
Long Term Rating	AA+/Negative	Affirmed
Alaska Energy Auth, Alaska		
Alaska		
Alaska Energy Auth (Alaska) pwr rev (Bradley Lake Hydroelectric Proj)		
Long Term Rating	A+/Negative	Affirmed
Alaska Mun Bnd Bank, Alaska		
Alaska		
Alaska Mun Bnd Bank (Alaska) approp		
Long Term Rating	AA/Negative	Affirmed
Alaska Mun Bnd Bank (Alaska) approp		
Long Term Rating	AA/Negative	Affirmed
Alaska Mun Bnd Bank (Alaska) approp		
Long Term Rating	AA/Negative	Affirmed
Alaska Mun Bnd Bank (Alaska) approp (AMBAC)		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Alaska Mun Bnd Bank (Alaska) GO and rfdg bnds (Alaska) ser 2016 FOUR due 12/01/2035		
Long Term Rating	AA/Negative	Affirmed
Alaska Mun Bnd Bank (Alaska) GO and rfdg bnds (Alaska) ser 2016 FOUR due 12/01/2035		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed

Ratings Detail (As Of February 14, 2017) (cont.)		
Alaska Mun Bnd Bank (Alaska) GO and rfdg bnds (Alaska) ser 2016 THREE due 12/01/2037		
Long Term Rating	AA/Negative	Affirmed
Alaska Mun Bnd Bank (Alaska) GO and rfdg bnds (Alaska) ser 2016 THREE due 12/01/2037		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Alaska Mun Bnd Bank GO		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Alaska Pension Oblig Bnd Corp, Alaska		
Alaska		
Alaska Pension Oblig Bnd Corp (Alaska) pension oblig bnds (Alaska) ser 2016 due 05/01/2039		
Long Term Rating	AA/Negative	Affirmed
Matanuska-Susitna Boro, Alaska		
Alaska		
Matanuska-Susitna Boro (Alaska) lse rev rfdg bnds (Alaska) (Goose Creek Correctional Ctr Proj)		
Long Term Rating	AA/Negative	Affirmed
Matanuska-Susitna Boro (Alaska) l(Goose Creek Correctional) approp		
Long Term Rating	AA/Negative	Affirmed
Preliminary Rating	NR(prelim)	
Matanuska-Susitna Boro (Alaska) (Goose Creek Correctional) approp (ASSURED GTY)		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed

Many issues are enhanced by bond insurance.