

# RatingsDirect®

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## Summary:

# Alaska Municipal Bond Bank; General Obligation

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### Credit Profile

US\$63.265 mil GO and rfdg bnds ser 2015A due 03/01/2045

*Long Term Rating* AA+/Stable New

US\$24.705 mil GO and rfdg bnds ser 2015B due 03/01/2035

*Long Term Rating* AA+/Stable New

## Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating to Alaska Municipal Bond Bank's (AMBB) \$88 million of general obligation (GO) bonds, 2015 series two. The bond bank is a public corporation of, and benefits from certain credit support by, the state of Alaska (AAA/Stable). At the same time, Standard & Poor's affirmed its 'AA+' long-term rating and underlying rating (SPUR) on AMBB's debt outstanding. The outlook is stable.

The ratings reflect our view of the strength of the appropriation pledge and the legislature's demonstrated commitment to include the appropriation in the state's annual operating budget.

The bonds are issued under AMBB's 2005 general bond resolution, which includes a standing appropriation feature, which 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 debt service reserve (DSR) to its defined level if there is a draw because of borrower default. As it has each year since 2009, in fiscal 2015, the legislature included and the governor signed, within the enacted operating budget, an open-ended appropriation to AMBB's reserve in the event of a borrower default. The legislature also appropriated any excess AMBB earnings to the AMBB rather than retain the funds for the state government. With the fiscal 2015 operating budget, the state has now included for seven consecutive years a standing appropriation in its operating budget to replenish the reserve should it be used and brought to below the required level. Alaska's fiscal 2016 budget is still under development; however, the appropriation was included in the governor's budget proposal, and it has been approved so far by the legislature.

We understand that, in practice, AMBB requires loan payment seven business days in advance of bond debt service, and in the event of a default by one or more of its underlying local government borrowers, it would coordinate with state administrative staff to implement the appropriation and would draw upon 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 state aid payments to the borrowing government as provided for in state statute.) And because the debt repayments by local governments occur on a rolling basis throughout the year, the standing appropriation allows 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 31 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 or the department of revenue.

During the 2015 legislative session, the state legislature approved Senate Bill 46, which allows AMBB to lend to Joint Action Agencies (JAAs) under the existing borrowing limit and up to \$205 million to "regional health organizations" (RHOs) under a separate borrowing limit. RHOs are nonprofit entities created through state statute for the purpose of delivering health care to state residents, in particular to the Native Alaskan population. Pursuant to Senate Bill 46, AMBB would only be 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 located 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. JAAs are a form of public utility created per state statute when two or more public utilities purchase power from a power project owned or formerly owned by the Alaska Energy Authority. The legislation also includes some technical amendments to AMBBs governing statutes that are intended to enhance the consistency of terminology with regard to AMBB's borrowers.

The 2015 series two bonds are the 32nd series of bonds issued under the 2005 general bond resolution. The bond bank estimates that, not including the 2015 series two bonds, it will have \$912.4 million of bonds outstanding. This consists of \$897.7 million of GO bonds, \$892.7 million of which will be outstanding under its 2005 general bond resolution, \$4.9 million under the 1976 general bond resolution, and \$4.3 million under the 2010 general bond resolution, as well as \$10.4 million of Coastal Energy Impact Loan Program obligations outstanding.

The 2015 series two bond proceeds will be used to make loans to:

- The city and borough of Juneau to refund its 2005 GO bonds,
- The city of Cordova for construction of a community center, and
- The municipality of Skagway to finance a public safety building.

In addition, proceeds will be used to refinance an estimated \$49.2 million in prior AMBB bonds that were issued from 2007 through 2009 to make loans to various communities within the state.

The bond bank plans to use unrestricted cash held in its custodian account to fund the increase in the common DSR 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. The bonds are general obligations of AMMB, which receives revenue from a pool of loans to municipalities and investment earnings on assets. According to the bond bank, as of March 31, 2015, the 2005 reserve fund market value was approximately \$51.3 million, an amount sufficient to satisfy the reserve fund requirement. The DSR fund will be funded by a contribution from the custodian account. The custodian account is where AMBB holds retained earnings, current-year investment earnings, or funds appropriated to AMBB by the state. According to the bond bank, as of March 31, 2015, the custodian account market value balance was \$20.7 million.

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 established 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. The state aid withholding provisions under the bond bank statute say that aid to municipalities will be withheld and paid directly to the bank if the participating unit defaults in the payment of principal or interest on its bonds held by the bank. The state aid intercept mechanism further strengthens the bonds' credit quality in our view. The AMBB tracks the amount of state aid subject to intercept relative to the annual loan payment due by each borrower. In all cases, the amount of state aid subject to intercept is greater than the amount of loan payments due by the borrowers. In fiscal 2015, coverage on the loan payments provided by the state aid intercept ranges from 2.71x to 12,511x.

For more information on the state GO rating, see the article published Feb. 27, 2015, on RatingsDirect.

### **State budget update**

Alaska's fiscal structure and budgetary context is unique among the states. Because the state's unrestricted general fund is heavily reliant on petroleum-related revenue, this segment of its finances has deteriorated throughout fiscal 2015 in response to the sharp and largely unanticipated decline in global oil prices. As of early February, Governor Bill Walker's administration estimates a large operating deficit of almost \$3.6 billion for fiscal 2015 in the state's unrestricted general fund (58% of authorized spending). Faced with a similar gap in fiscal 2016, the governor's budget proposal recommended bringing down unrestricted general fund spending by 9.5% to about \$5.6 billion. Of this, the governor proposed cutting about \$284.2 million in unrestricted general fund operating expenses. Although the governor has proposed significant spending reductions, he has taken a targeted rather than an across-the-board approach. The governor's budget plan included eliminating more than 300 state jobs, many of which are currently or are expected to become vacant. He also put a hold on several large capital projects. The legislature, while still in session, is poised to approve deeper spending cuts in addition to approving the governor's previously proposed spending cuts. Between the state house and senate, cuts to unrestricted general fund operations would total about \$470 million as of April 20, 2015. The legislature's actions on the budget in early April roughly coincided with the release of the state's spring revenue forecast, which reduced the fiscal 2015 revenue estimate by \$400 million. Alaska's statutory and constitutional budget reserves and its permanent fund earnings reserve sum to \$19.95 billion, or 326% of fiscal 2015 expenditures. Its extraordinary reserves provide the state time to address its large fiscal gap, but we are monitoring whether state policymakers are willing and able to assemble structurally oriented corrective fiscal measures that would bring the state back into budgetary alignment.

### **Outlook**

The stable outlook on the bonds matches that of our 'AAA' rating on the state's GO debt and has long encompassed the potential for oil price declines. The stable outlook reflects that Alaska has prudently and effectively used prior revenue windfalls to accumulate extraordinarily large budget reserves. In our view, the budget reserves enable the state to weather a period of structural -- and large -- budget imbalances. As we see it, the state has a sufficient level of

reserves to withstand the shortfall in its unrestricted general fund for at least two years -- which is the time horizon of our outlook. The time horizon could shorten, however, if oil prices or production levels fall and remain materially below what the state forecasts.

## **Related Criteria And Research**

### **Related Criteria**

- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Moral Obligation Bonds, June 27, 2006

### **Related Research**

U.S. State And Local Government Credit Conditions Forecast, April 2, 2015

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