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Ratings

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Summary:

Alaska
Alaska Municipal Bond Bank; General Obligation

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Credit Profile		
US$12.625 mil GO bnds (AMT) (Alaska) ser 2018 ONE due 12/01/2038		
Long Term Rating	AA-/Stable	New

Rationale

S&P Global Ratings assigned its 'AA-' rating to Alaska Municipal Bond Bank's (AMBB) $12.6 million in 2005 master resolution general obligation (GO) bonds, series 2018 One. The bond bank is a public corporation of, and benefits from certain credit support by, the state of Alaska. The outlook is stable.

The bonds are rated one notch off the state of Alaska's general creditworthiness based on a standing appropriation to replenish the debt service reserve (DSR) to its required level if there is a draw because of a borrower default. 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 GOs 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. There has never been a borrower default in the history of the program or draw on the DSR.

The rating reflects our view of:

- The state's underlying general creditworthiness ('AA/Stable' GO rating), and
- A resolution provision to annually seek an appropriation to replenish the DSR to its required level if it is drawn on.

The series 2018 One bonds are the 41st 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 required 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, in fiscal 2019, 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 fiscal 2019 budget represents the eleventh 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 38 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 2018 One proceeds provide new-money loans toward two projects in the City and Borough of Sitka. Sitka will apply approximately $8 million to the replacement of deteriorated infrastructure at Crescent Harbor. Additionally, Sitka will apply approximately $4 million to renovate the Rocky Gutierrez Airport terminal, primarily for improvements to the efficient flow of arriving and departing passengers.

No additional reserve deposit will be required for the 2018 One bonds as existing assets in the 2005 resolution reserve fund (including cash and DSR sureties) exceed the post-2018 One 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 GOs of the AMBB, which receives revenue from a pool of loans to municipalities and investment earnings on assets.

According to the bond bank, with the sale of the 2018 One bonds, the 2005 reserve fund requirement is estimated at approximately $61.4 million. The bond bank has an amount sufficient to satisfy the reserve fund requirement, consisting of the following:

- $36.8 million of cash contributions in the custodian account (that account is where AMBB holds retained earnings, current-year investment earnings, or unrestricted funds appropriated to AMBB by the state);
- $7.1 million in reserve obligation proceeds of AMBB (the AMBB plans to payoff the remaining reserve obligations and replace those funds with a DSR fund surety); 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.

Fiscal and economic update on the state

The adopted 2019 budget totaled approximately $5 billion, including the Permanent Fund dividend. For the first time, Alaska approved a $2.7 billion transfer from the earnings reserve account to unrestricted general fund for the year. Of the transfer, $1.7 billion (34% of appropriations) will be used for unrestricted general fund expenditures. Use of the earnings reserve account was agreed on in SB 26, which allows the legislature to spend up to 5.25% of the Permanent Fund's average balance at June 30 over the prior five years before dropping to 5% in 2021. However, like the statutory requirement for the dividend that has been annually reduced, SB 26 cannot bind future legislatures. For the state to permanently limit the amount of the draw, a constitutional amendment is required. Nonetheless, the bill provides needed guidance for how the state intends to fund its operating deficit in the future.

The use of the earning reserve account, and its expected continued use as a permanent revenue source, reduced the operating deficit to $674 million, which will be funded through use of the Constitutional Budget Reserve (CBR). If the Alaska North Slope oil average reaches $70-$75 per barrel for the year, the state will likely not need to draw on this reserve fund. The price per barrel is currently above target and depending on economic conditions for the year, the state may completely eliminate use of the CBR for the year.

Alaska remains the country's third-largest oil producer. According to IHS Markit, as the ailing energy markets begin to rebound, the state will return to more normal employment gains, and is forecast to experience 1.0% average annual growth over the next five years, with the recovering natural resources and mining sector leading growth, posting average annual gains of 4.0%. The state continues to rely heavily on oil production as part of its revenue profile. Last year, Spanish oil company Repsol and its privately held U.S. partner Armstrong Energy announced a discovery of 1.2 billion barrels of oil in Alaska, marking the biggest onshore discovery in the U.S. in three decades. The company predicted production could begin as soon as 2021 and lead to as much as 120,000 barrels of output per day, providing a much-needed boost to state coffers.

For more information, see the full analysis on Alaska, published June 8, 2018, on RatingsDirect.

Outlook

The stable outlook reflects Alaska's fiscal 2019 budget with adopted structural reforms allowing a planned use of its Permanent Fund earnings reserve account to fund operating expenditures, which has reduced the state's structural deficit and may allow it to rebuild its more customary reserve balances, particularly the CBR. Even with significant use of reserves since 2015, the state maintains available balances in excess of 3x expenditures, which provides rating stability. The state is also benefiting from a resurgence in oil prices that should provide additional budgetary flexibility and may allow it to rebuild reserve levels. We do not expect to change our rating within the next two years.

Upward movement on the rating will depend on the state's ability to grow and maintain its reserve levels. Despite the large reserve balances, Alaska is more sensitive to economic volatility than its peers due to its unique revenue structure, which requires it to maintain above-average reserve levels. The state's rating could further benefit from economic diversification. However, should unanticipated economic shocks reduce budgetary flexibility or weaken its ability to further structurally align its budget, we may lower the rating.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.