

RatingsDirect®

Summary:

Anchorage, Alaska; Appropriations; General Obligation

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Credit Profile

US\$59.465 mil 2021 taxable GO rfdg bnds (schools) ser 2021D due 09/01/2035		
<i>Long Term Rating</i>	AA+/Negative	New
US\$53.14 mil 2021 GO bnds (schools) ser C due 09/01/2041		
<i>Long Term Rating</i>	AA+/Negative	New
US\$46.225 mil 2021 taxable GO rfdg bnds (gen purp) ser 2021B due 09/01/2035		
<i>Long Term Rating</i>	AA+/Negative	New
US\$43.260 mil 2021 GO bnds (gen purp) ser 2021A due 09/01/2041		
<i>Long Term Rating</i>	AA+/Negative	New
Anchorage GO		
<i>Long Term Rating</i>	AA+/Negative	Downgraded

Rating Action

S&P Global Ratings lowered its rating to 'AA+' from 'AAA' on Anchorage Municipality, Alaska's outstanding general obligation (GO) and certificates of participation (COPs). In addition, we lowered our rating to 'AA' from 'AA+' on the municipality's outstanding COPs. At the same time, we assigned our 'AA+' rating to the municipality's series 2021A (\$43.3 million), 2021B (\$46.2 million), 2021C (\$53.1 million), and 2021D (\$59.5 million) GO and GO refunding bonds. The outlook on all ratings is negative.

The downgrades reflect a material decline in the municipality's available reserves, which is expected to worsen in fiscal 2021. Officials hope to increase fund balances in 2022 and 2023, but they face numerous challenges to restore reserves.

The municipality's full faith credit and resources, including an obligation to levy ad valorem property taxes without limitation as to rate or amount, secure the GO bonds. The municipality's COPs are payable from lease payments by the municipality for use and possession of the leased assets without the ability to abate payments, and our rating is set one notch below our view of the municipality's general creditworthiness due to appropriation risk. Under the lease agreement, the municipality agreed to budget and appropriate for COPs payments, which occur on Jan. 1 and July 1. Although the first payment occurs at the beginning of the fiscal year and no reserve fund is required, the municipality must adopt its proposed budget by Dec. 15 in the event that the municipality's budget has not yet been adopted. In our view this largely mitigates the risk of late payment.

Proceeds from the 2021 issuances will fund a variety of continuing capital projects in Anchorage, capital projects for Anchorage schools, and refund the municipality's series 2015A and 2015B debt.

Credit overview

The municipality's available reserve position declined to \$27.6 million in fiscal 2020 from 13.1% of expenditures or \$59.3 million in fiscal 2019, with reserves expected to decline further in fiscal 2021. While the municipality has a large trust fund (Municipality of Alaska Trust) with \$417 million as of December 2020, the municipality's charter prescribes the annual dividend amount of up to 5% of the balance of the fund and the municipality would need to approach voters to increase the yearly distribution, limiting Anchorage's access to these funds. Therefore, in our view, reserves are no longer comparable with those of 'AAA' peers and, if worst-case projections come true in fiscal 2021 and management is unable to respond, reserves could decline to levels equivalent to peers rated lower than 'AA+', which supports our view of a negative outlook. Capital expenditures from the 2018 earthquake, revenue declines from COVID-19, and the cost and labor shortages associated with construction in Alaska, and delayed Federal Emergency Management Agency (FEMA) reimbursements have forced the municipality to draw down its reserves. We believe that economic conditions are slightly improving, particularly tourism when compared with 2020, despite longstanding population and job loss trends, and that a good management team is making efforts to address these challenges. Officials hope to restore reserves to the municipality's formal reserve target by 2022 or 2023. However, given the substantial challenges facing the municipality's available reserves in the short term, we are lowering the rating and changing the outlook simultaneously.

The rating reflects our view of the municipality's:

- Broad and diverse economy that is strategically located as a logistics, distribution, and tourism hub;
- Adequate reserves that are expected to decline further;
- Manageable debt burden, with rapid amortization; and,
- Good management, with comprehensive long term capital planning, and a fiscal 2022 budget that shows expenditure reductions; and strong institutional framework.

Environmental, social, and governance

We analyzed the municipality's governance factors relative to its economy, management, budgetary outcomes, and debt and liability profile and determined that the municipality's governance risks are in line with the sector standard. We consider the municipality's social factor slightly higher than that of other peers, given the gradual population decline, which we believe could materially affect its property tax base. We consider the municipality's environmental risks higher than the sector standard given Anchorage's history with earthquakes and changing weather, which have led to melting permafrost and receding glaciers in the region.

Offsetting some of the environmental risks is the municipality's Climate Action Plan, passed in 2019. Officials have installed solar, LED lighting, and have set emissions goals. The plan identifies seven priorities, including areas such as buildings and energy, consumption and solid waste, health and emergency preparedness and education. A new administration is currently reevaluating how to address elements in the plan and formulating their own approach at this time.

Negative Outlook

Downside scenario

If the municipality is unable to restore reserves to their fund balance targets in 2022 and 2023, we could lower the rating.

Return to stable scenario

If the municipality restores reserves through a combination of FEMA reimbursements or reducing expenditures, we could revise the outlook to stable.

Credit Opinion

Broad and diverse economy that anchors Alaska and has shown signs of recovery from COVID-19, but it faces long-term population and job loss decline

Anchorage serves as the economic center of the nation's largest state--by geography--and its location between Asia and the U.S. mainland has contributed to an enduring role as a military and air logistics hub. The municipality has what we consider mostly indirect economic exposure to the ups and downs of the state's prominent oil and gas industry in the form of administrative and finance activities that serve Prudhoe Bay in northeast corner of the state. Oil prices have recovered after the pandemic, currently hovering around 80 dollars a barrel, which has provided some stability to the state budget. However, the local economy saw significant tourism declines in 2020 from the pandemic, 2020 hotel and motel revenues came in at \$12 million, far under the \$30 million collected in 2019. There are signs of recovery, and management expressed surprise at the amount of air travel visitors, given that cruise ships still are not travelling to Anchorage, and that for much of 2020, Canada closed its borders to recreational vehicle traffic from the U.S.

The municipality's population has been slightly declining, with 2020 population dropping by approximately 13,000 when compared with 2013. There is no clear reversal to this trend in sight, and although higher oil prices generally attract additional workers to Alaska possibly slowing down the decline, we expect current population trends will continue.

Despite the population decline, assessed value (AV) is projected to remain stable in fiscal 2020 due to new construction, although the municipality is projecting a decline in AV in 2021. The municipality states that \$400 million worth of new construction projects are under development in the municipality, with another \$50 million-\$60 million in projects recently announced. These consist mostly of hotel and mixed-use developments, as well as a planned expansion to Ted Stevens international airport. Some of these projects are delayed given labor constraints and high supply costs in Alaska, with lumber prices remaining high.

Like many other municipalities, Anchorage saw a spike in unemployment during the pandemic, however, the city has seen unemployment rates drop under 5%. Over the past five years, Anchorage experienced steady employment declines, with the biggest coming in the health care, tourism, and construction sectors. The pandemic exacerbated the decline in 2020, with 12,400 jobs lost in 2020, but the municipality expects other sectors will generate 4,000 new jobs in 2021, and management is projecting a similar increase in 2020.

Strong management with comprehensive budgets, and an awareness of the challenges facing the municipality

We have changed our view of Anchorage's management from very strong to strong, as the municipality is no longer in line with its formal reserve target.

The municipality's financial management policies and practices include:

- Budget process that involves extensive analysis of expenditure trends, major goals, and the economic outlook to validate assumptions;
- Monthly updates to the assembly (the municipality's legislative body) on budget-to-actual performance;
- Annually updated six-year projection model that informs management's budget recommendations and forward-looking analyses of trends affecting financial performance, although its details are not always included in the formal budget document;
- Annually updated capital planning practice that addresses the timing and costs of capital projects, but also the implications for ongoing noncapital costs;
- Investment management under an internal policy and monthly reporting to the assembly on performance and holdings;
- A formal comprehensive debt management policy that regulates issuance, type of debt issuance, and overall debt levels;
- Formal minimum reserve policy of 10% of expenditures to provide comfort to the credit markets and an additional 2%-3% reserve for emergencies. However, the assembly just signed a resolution allowing an exception to handle COVID-19- and earthquake-related expenses; and
- Anchorage maintains a cyber-security insurance policy as well as a formal security document that follows best practices from the National Institute of Standards and Technology. The municipality disclosed an incident where personal information was inadvertently made available to the public. Individuals affected by the exposure of information were notified, and the municipality offered credit-protection programs to those affected.

Deteriorating reserves due to delayed FEMA reimbursements and adequate performance significantly affected by COVID-19 and the 2018 Earthquake

Available fund balances have declined in the past two years to 6.4% of expenditures, or \$27.6 million dollars, largely driven by 2018 earthquake expenditures and COVID-19. Tourism revenue in Anchorage saw large revenue shortfalls in fiscal 2020; however, property tax, which is the majority of the municipality's revenues (70%), remained stable with receipts increasing to \$588 million from \$558 million in 2019. Anchorage reported \$12 million in hotel and motel tax receipts compared with \$30 million in fiscal 2019. Local taxes dominate Anchorage's general fund revenue structure, with local sources comprising nearly all revenue as state and federal revenues make up less than 2% of total revenues. The municipality reported an operational surplus of \$2.2 million in fiscal 2020 and it reported adding \$30 million to fund balances, but most of these fund balances were spent in the first quarter of 2021 for COVID-19-related programs (\$29 million). Management attributes fund balance declines to a delay in FEMA reimbursements, stating that projects must be completed prior to requesting reimbursement.

Management continues to explore additional revenue sources, not limited to and including utility rate increases for the water utility and solid waste services utility, an increase to fees and tariffs at the Port of Alaska, an increase in parking

rates in Anchorage, and increasing fees for aircraft at Merrill Field. In addition, the municipality received over \$215.8 million in federal pandemic stimulus, with \$156.7 million in CARES Act funding and \$23.7 million in American Rescue Act funding, which management plans to use on public safety, housing, community efforts, and economic stimulus. On the expenditure side, the municipality committed to sustainable cuts to expenditures including eliminating 54 positions and reductions in virtually all departments aside from public safety or other critical services. Management expects to spend down fund balance in fiscal 2021 related to COVID-19 and Earthquake expenditures, but it is planning on restoring fund balances in 2022 and 2023.

Our analysis of the municipality's available general fund balance includes the portion classified as committed for its "bond rating"--a designation that leads us to view it as practically available if needed--maintained under a policy that calls for a minimum of 10% of expenditures, in addition to a 2%-3% emergency reserve. In addition, the municipality's reserves are supported by a large trust fund, which contributes a set percentage each year for operations.

Our fund balance calculations do not include the municipality's sizable MOA Anchorage trust. The trust dates back to 1999 when it was set up to manage the proceeds of the sale of the municipality's telephone utility. The recent sale of the electric utility added more than \$220 million to the trust, with the fiscal 2020 audit reporting \$417 million as of Dec. 31, 2020. The charter governing the trust limits annual transfers to the general fund to 5%. Any change to the allocation of the trust over 5% annually, must be approved by voters, and at this time, Anchorage officials do not plan on advocating for any changes to the formula. The Anchorage Municipal Code describes how the trust fund is managed and the assembly can make changes at any time.

Manageable debt profile with rapid amortization and elevated pension obligations

The municipality reduced enterprise debt by \$513 million following the sale of the electric utility, with the municipality carrying \$1.25 billion of net direct debt. We anticipate the municipality will continue a pattern of approximately annual GO debt issuances consistent with a capital plan that call for \$50 million-\$100 million to be issued each year and existing voter-approved GO debt authorizations, and management expects to issue approximately \$120 million next year. The municipality could also issue approximately \$200 million in revenue debt as a part of a broader financing plan to address pilings at the Port of Alaska, depending on federal funding as well as the result of litigation concerning engineering at the port. In addition, we expect the municipality will continue to issue tax anticipation notes on a yearly basis in order to maintain its investment portfolios and provide additional liquidity. However, we don't anticipate its net direct debt burden will increase significantly relative to its operations or tax base in the near term.

We also note that the state historically supported the municipality's school debt through a reimbursement program, but due to budgetary pressures, the state eliminated portions of the reimbursement in recent budgets, with the state legislature reducing the reimbursement by 60% or \$20.4 million in 2021. In response, the municipality has raised property tax rates to compensate.

Anchorage's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 10.7% of total governmental fund expenditures in 2020. Of that amount, 6.9% represented required contributions to pension obligations, and 4.0% represented OPEB payments. The municipality made its full required pension contribution in 2020.

Elevated pension costs, which could rise if the state decreases its contributions

We consider the municipality's pension a source of potential credit pressure if the state, reduces its contributions toward pension plans. The municipality contributes 22% of employee salaries to the Alaskan Public Employees Retirement System (PERS), while the state funds the residual needed to fully fund the plans' actuarially determined costs. If the state lowers its contributions, we could consider the municipalities' pension contributions large.

Anchorage participates in the following plans:

- Alaska PERS, funded at 61.6% with a net pension liability of \$419 million
- Police and Fire pension System, funded at 88.3%, with a liability of \$51.8 million
- PERS Defined Contribution Plan
- Five OPEB plans in both PERS and the Police and Fire Retiree Medical Trust Plans (PFRMT),
- PERS Retiree medical plan and two PFRMT plans have a net liability of \$119.7 million,
- Two PERS plans, Alaska Retiree Healthcare Trust and Occupational Death and Disability have a net OPEB assets of \$31.4 million.

The municipality and its employees participate in three cost-sharing, multiple-employer plans provided by Alaska PERS and boards associated with the municipality manages three small closed plans. Similar to the municipality's income statement reporting, we understand that its pension contributions exclude those that the school district component unit makes to PERS. The pension plan features a 7.38 percent discount rate, which indicates a significant exposure to market trends and conditions, which could cause the liability to fluctuate in the near term. With a closed layered 25-year amortization period, we believe the municipality will gradually make progress towards full funding, and we consider the closed layered amortization schedule conservative, which limits contribution volatility. However, the amortization period is a level-percent of payroll, which introduces risk of higher contributions, if not enough new entrants are hired to maintain the assumed payroll growth assumption of 2.75%. This is a risk given the municipality's declining population.

Strong institutional framework

The institutional framework score for Alaska is strong.

Anchorage, Alaska--Key Credit Metrics				
	Most recent	Historical information		
		2020	2019	2018
Very strong economy				
Projected per capita EBI % of U.S.	116.4			
Market value per capita (\$)	118,985			
Population		291,014	294,468	298,979
County unemployment rate(%)		7.4		
Market value (\$000)	34,626,425	34,757,231	34,663,903	
Ten largest taxpayers % of taxable value	3.4			
Adequate budgetary performance				
Operating fund result % of expenditures		7.1	(1.3)	0.7

Anchorage, Alaska--Key Credit Metrics (cont.)

	Most recent	Historical information		
		2020	2019	2018
Total governmental fund result % of expenditures		4.0	5.8	3.9
Weak budgetary flexibility				
Available reserves % of operating expenditures		6.4	9.9	13.1
Total available reserves (\$000)		27,556	47,566	59,292
Very strong liquidity				
Total government cash % of governmental fund expenditures		58.8	74.7	80.1
Total government cash % of governmental fund debt service		514.9	555.3	613.1
Strong management				
Financial Management Assessment	Good			
Adequate debt & long-term liabilities				
Debt service % of governmental fund expenditures		11.4	13.4	13.1
Net direct debt % of governmental fund revenue	131.2			
Overall net debt % of market value	3.6			
Direct debt 10-year amortization (%)	67.2			
Required pension contribution % of governmental fund expenditures		6.7		
OPEB actual contribution % of governmental fund expenditures		4.0		
Strong institutional framework				

Data points and ratios may reflect analytical adjustments. EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of November 23, 2021)

Anchorage APPROP		
Long Term Rating	AA/Negative	Downgraded
Anchorage GO		
Long Term Rating	AA+/Negative	Downgraded
Anchorage GO		
Long Term Rating	AA+/Negative	Downgraded
Anchorage GO		
Long Term Rating	AA+/Negative	Downgraded
Anchorage GO		
Long Term Rating	AA+/Negative	Downgraded
Anchorage GO		
Long Term Rating	AA+/Negative	Downgraded

Summary: Anchorage, Alaska; Appropriations; General Obligation

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.

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