S&P Global
Ratings

RatingsDirect®

Anchorage, Alaska; Appropriations; General Obligation

Primary Credit Analyst:
Alex Louie, Centennial + 1 (303) 721 4559; alex.louie@spglobal.com

Secondary Contact:
Calix Sholander, New York + 1 (303) 721 4255; calix.sholander@spglobal.com

Table Of Contents

Anchorage, Alaska; Appropriations; General Obligation

Credit Profile		
US$83.307 mil GO bnds (General Purpose) ser 2022A due 09/01/2042		
Long Term Rating	AA/Negative	New
US$22.205 mil GO bnds (Schools) ser 2022B due 09/01/2042		
Long Term Rating	AA/Negative	New
Anchorage APPROP		
Long Term Rating	AA-/Negative	Downgraded
Anchorage GO		
Long Term Rating	AA/Negative	Downgraded

Credit Highlights

- S&P Global Ratings lowered its rating to 'AA' from 'AA+' on the Municipality of Anchorage, Alaska's general obligation (GO) debt outstanding.
- At the same time, S&P Global Ratings lowered its rating to 'AA-' from 'AA' on the municipality's certificates of participation (COPs) debt outstanding.
- In addition, we assigned our 'AA' rating to Anchorage's series 2022 A ($83.3 million) general purpose GO bonds and series 2022 B ($22.2 million) school GO bonds.
- The outlook for all ratings is negative.
- The downgrades reflect deterioration in the municipality's general fund reserves to negative levels in the 2021 audit, which could continue through fiscal 2022, and which could persist due to uncertainty on the timeliness of Federal Emergency Management Agency (FEMA) reimbursements.

Security

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 2022 issuances will fund a variety of projects for public safety and transportation, roads, police, fire, and other facilities.

Credit overview

The municipality's unassigned reserves, a key factor behind the one-notch downgrade, dropped to negative levels as of fiscal 2021 due to outstanding FEMA reimbursements and state assistance from the 2018 earthquake, COVID-19-related revenue losses, and a recent avalanche in the northern part of the municipality that led to unexpected expenditures. While we understand that after natural disasters the FEMA reimbursement process can take time, in our view, the delay following the 2018 earthquake has been unusually drawn out. Officials stated they are evaluating both revenue and expenditure adjustments to mitigate the municipality's negative reserve position, but to date we have not seen evidence of either revenue raising or expenditure reductions to mitigate reserve drawdowns in audited financials or in the fiscal 2022 and 2023 budgets. In addition, financial projections provided by the municipality in recent years have worsened, with officials initially expecting reserves to recover in 2022 to 5.0% of expenditures, but now expecting reserves to recover to 2.6%. The management team has seen turnover, with Anchorage now on its third CFO in the past two years, with uncertainty about who the permanent CFO will be. Assessed value (AV) is expected to grow in the next two years, despite declining population, and should provide officials with options to address negative reserves. We do not envision the municipality will recover reserves to historical levels until the fiscal 2024 audit at the earliest, which will not be complete until 2025. Therefore, given our expectations of continued operations with negative unassigned reserves, we have lowered the rating one notch and maintain a negative outlook.

The rating reflects our view of the municipality's:

- Weak reserve position, with negative fund balances, offset by very strong liquidity;
- Broad and diverse economy, albeit with a declining population, which serves as Alaska's logistics, distribution, and tourism hub;
- Manageable debt burden, with rapid amortization, but large pension liabilities;
- Strong management policies in place, but with a leadership team in transition, including an interim CFO; and
- Strong institutional framework score.

Environmental, social, and governance

We analyzed the municipality's governance factors relative to its economy, management, budgetary outcomes, and debt and liability profile and view them as elevated given the recent turnover with both the CFO and the mayor. We consider the municipality's social risk factors to be slightly higher than those of other peers, given the gradual population decline, which we believe could materially affect its property tax base. We also consider the municipality's environmental risks elevated given Anchorage's history with earthquakes and climate-change trends, which have led to melting permafrost and receding glaciers in the region.

Outlook

Our negative outlook reflects our view that we expect reserves could remain negative in the near term given delays in reimbursements, and while management expects reserves will return to historical levels when FEMA reimbursements arrive, starting as soon as next year, previous projections have not matched current actual performance. We believe there is at least a one-in-three chance we could lower the rating again if the municipality does not begin to restore reserves.

Downside scenario

If the municipality is unable to balance operations and return fund balances to positive levels or show progress toward positive fund balances within the next two years, we could lower the rating.

Upside scenario

We could consider a positive rating action if Anchorage brings reserves to a positive level and sustains balanced budgetary performance for multiple years.

Credit Opinion

Broad and diverse economy that anchors Alaska, but with a declining population

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. However, during the pandemic, oil prices declined significantly, affecting the local economy as many oil workers reside in Anchorage. In addition, cruise ships were barred from stopping in the municipality, decreasing tourism-related revenues. Both sectors have seen an improvement, with oil prices recovering to more than 90 dollars a barrel and hotel- and tourism-related revenues recovering well after the pandemic, with hotel tax revenues increased to $29 million in 2021, after falling to $13 million in 2020.

Our long-term view of the local economy is tempered by the municipality's long trend of population decline, despite projected AV growth in 2022 and 2023. Officials provided a list of new developments in the municipality, most residential in nature, including three new multifamily housing buildings, and a new mixed-use development. The municipality's population has been slightly declining for more than a decade, with 2022 population declining by 12,500, or 4.5% when compared with 2013, with further declines expected. 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, and although market value per capita could rise in the near term, we believe the population decline will serve as a drag on economic growth and revenues.

Weak performance and weak reserves due to delayed FEMA reimbursements and optimistic budget projections in 2021

Historically, Anchorage maintained unassigned fund balances in compliance with its formal fund balance policy, but the combination of a major earthquake, lost revenues to COVID-19, and a recent avalanche in the northern part of the municipality have added expenditures that propelled unassigned fund balances to negative $10.4 million in fiscal 2021 or negative 1.9% of expenditures. Officials estimate more than $145 million in unexpected expenditures due to these events and have received $56 million from FEMA, while waiting for an additional $29 million in reimbursements. The timing of the reimbursements has been slower than officials anticipated, and they don't expect full reimbursement until 2024, although they expect reserves will increase in 2022 given revenues coming in $20 million over budgeted, with some FEMA reimbursements received. This stress on the municipality's finances is the primary driver for recent rating actions, and in our view negative balances could persist.

At this time, we do not have liquidity concerns, as the municipality has multiple restricted fund balances totaling \$113.3 million. The fiscal 2021 audit reported over \$391 million in cash and investments in the central treasury. Anchorage also has a \$448 million trust, which contains the proceeds of the sale of previous utilities. The disbursements from this fund are governed by city law and limited to a certain percentage each year, and at this time officials have no plans to attempt to access these funds beyond the typical yearly disbursements.

Management is considering a variety of options to restore fund balances, including both revenue and expenditure options. However, in 2021, expenditures increased to \$843 million, a 20% increase from 2020, while revenues increased 7.5%. In addition, last year, management projected a recovery to a 5% percent fund balance in 2022, but now it expects reserves will increase to 2.6%. While we understand that FEMA reimbursements are often delayed compared with municipalities' actual spending, we reviewed many other issuers that have suffered significant damages from natural disasters, but have received nearly all FEMA reimbursements, or have taken steps such as issuing hurricane relief bonds to limit fund balance drawdowns. While each local government has unique circumstances, in our view, Anchorage is taking longer than many other issuers to adjust budgets or receive FEMA expenditures. Management provided balance-sheet scenarios showing fund balances if all FEMA reimbursements were received, showing positive fund balances similar to historical levels.

Strong management due to established practices and long-term policies, but inexperienced in dealing with FEMA reimbursements and uncertainty on how to address negative fund balances

The municipality's management is in transition with an interim CFO currently in place and having three mayors in the past three years. The previous mayor resigned in October 2020, replaced by an interim, who then was replaced by a new elected mayor in 2022. The current interim CFO is the third CFO in the past two years, and there is uncertainty on who will fill the position permanently. Our view is that while day-to-day accounting and budgetary functions, long-term planning processes, and debt-management functions will not be affected and remain strong in our view, consequential decisions about potential service cuts or revenue increases to address the negative fund balance are uncertain since leadership must consult with the assembly for approval. If the municipality continues to only wait for FEMA reimbursements, without taking additional actions if reimbursements do not arrive as expected, we could change our view of Anchorage's management.

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, which the municipality is not in compliance with; 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.
- We consider Alaska's institutional framework score strong.

Manageable debt profile, with rapid amortization

We anticipate the municipality will continue a pattern of approximately annual GO debt issuances consistent with a capital plan that calls for $50 million-$100 million to be issued each year and existing voter-approved GO debt authorizations. 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.

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 76.5% with a net pension liability of $316.8 million
- Police and fire pension system, funded at 95.2%, with a liability of $20.9 million
- Police, Fire, Medical Trust other postemployment benefits (OPEB), funded at 26.5% with a $64.8 million liability
- Gentile Defined Benefit Plan, unfunded with a liability of $72.6 million
- Three OPEB plans, Alaska Retiree Healthcare Trust, Retiree Medical, and Occupational Death and Disability with new assets of $229.7 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% 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 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 the 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.

Anchorage, Alaska--Key Credit Metrics				
	Most recent	Historical information		
		2021	2020	2019
Very strong economy				
Projected per capita EBI % of U.S.	120.0			
Market value per capita ($)	120,661			
Population		286,633	291,014	294,468
County unemployment rate(%)		5.8		
Market value ($000)	34,585,382	36,657,964	34,757,231	
Ten largest taxpayers % of taxable value	3.3			
Very weak budgetary performance				
Operating fund result % of expenditures		(16.5)	7.1	(1.3)
Total governmental fund result % of expenditures		(3.9)	4.0	5.8
Weak budgetary flexibility				
Available reserves % of operating expenditures		(1.9)	6.4	9.9
Total available reserves ($000)		(10,400)	27,556	47,566
Very strong liquidity				
Total government cash % of governmental fund expenditures		52.0	58.8	74.7
Total government cash % of governmental fund debt service		578.4	514.9	555.3
Strong management				
Financial Management Assessment	Good			
Adequate debt and long-term liabilities				
Debt service % of governmental fund expenditures		9.0	11.4	13.4
Net direct debt % of governmental fund revenue	128.3			
Overall net debt % of market value	3.8			
Direct debt 10-year amortization (%)	68.9			
Required pension contribution % of governmental fund expenditures		5.7		
OPEB actual contribution % of governmental fund expenditures		3.1		
Strong institutional framework				

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

Related Research

- Credit Conditions North America Q2 2022: Hazard Ahead: Risk Intersection, April 16, 2021
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022
- 2022 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of November 23, 2022)		
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