Analytical Conclusion: The 'AA+' Issuer Default Rating (IDR) and GO ratings reflect the municipality's superior financial resilience to typical cyclical stresses, solid expenditure flexibility and moderate long-term liability burden balanced against a somewhat constrained revenue raising flexibility.

The 'AA' certificate of participation (COP) rating is one notch lower, reflecting a slightly higher degree of optionality associated with appropriation debt. The 'AA-' rating on the CIVICVentures hotel tax revenue bonds reflects Fitch Ratings' dedicated tax analysis, and the solid resilience of the pledged revenues to expected revenue volatility, as well as Fitch's expectations for limited future leverage of the revenue stream.

Economic Resource Base: The municipality is the center of business, trade, transportation, healthcare, education, government and tourism for the state of Alaska. The municipality is home to about 40% of the state's population with about 300,000 residents and produces more than half of the state's economic output. Both Anchorage and the state of Alaska are currently experiencing an economic downturn due to a prolonged period of low oil prices.

Key Rating Drivers

Revenue Framework: 'a'

Fitch expects revenue growth in line with inflation over time, but the municipality may experience some near-term weakness due to economic conditions. Anchorage's tax limitations generate revenue stability, but policymakers' independent legal ability to raise revenues is moderate relative to typical cyclical revenue declines.

Expenditure Framework: 'aa'

Fitch expects expenditure growth to track revenue growth over time, although the municipality may face expenditure increases that are marginally above revenue growth over the near term. Expenditure flexibility is solid, allowing policymakers to address gaps as they arise.

Long-Term Liability Burden: 'aa'

The long-term liability burden is moderate relative to the economic resource base.

Operating Performance: 'aaa'

Anchorage is well positioned to withstand a period of economic weakness with robust reserves relative to very limited revenue volatility. Budget management in times of recovery is strong.
### Rating Sensitivities

**Economic Vulnerability:** The IDR, GO and COP ratings could come under downward pressure if the current economic downturn is notably deeper and more durable than past periods of weakness, leading to outmigration of residents and erosion of the revenue base. The ratings could also come under downward pressure if the municipality fails to adjust spending to match available revenues during the current period of economic weakness. The rating is unlikely to move higher due to the concentration of the economy and legal constraints on tax policy.

**Room Tax Leverage:** The CIVICVentures hotel tax revenue bond rating could come under downward pressure if the municipality significantly further leveraged the room tax revenue stream.

**State Budget Proposals:** The state faces budget pressure as it aligns expenditures with falling revenues due to low oil prices. Recent budget proposals from the governor, currently in his first year, would have materially shifted previous state spending to local governments and reduced local taxing authority. Many of the most consequential proposals faced roadblocks or have been whittled down significantly during the current budget negotiations. As the state continues addressing its budget issues, significant cost burdens or revenue reductions to the municipality could cause downward rating pressure on the IDR, GO and COP ratings.

### Credit Profile

Anchorage's economy, like the state's, is driven primarily by the energy and government sectors. Anchorage serves as the headquarters city for major oil and oilfield services companies doing business in the state. The sector also drives a significant degree of the municipality's construction, financial services, professional and business services and retail sectors. The municipality also has significant tourism, healthcare, transportation and trade industries.

The state's energy sector is highly cyclical and in gradual decline due to falling production in mature oil fields. There are significant untapped oil and gas resources throughout the state that may be exploited in the future. However, such projects are quite sensitive to energy prices. While some players have increased investments and oil prices have risen somewhat from their recent lows, the overall trend in oil capital spending is expected to remain negative so long as prices remain subdued. The decline in oil prices has led to sharp reductions in state revenues, which are driven by royalty payments. Most local revenues in Alaska are driven by changes in residential property values, which lag activity in the energy sector and broader economy and have been much more stable than state revenues historically, but local governments are exposed to changes in state aid to municipalities.

A large government sector adds a degree of stability. Joint Base Elmendorf-Richardson employs about 16,000 soldiers and civilian employees. The state of Alaska and the municipality itself are also major employers.

The Anchorage economy has experienced mixed results particularly given the state's weakened economy. The positive economic results include a growing tourism sector, a slightly lower unemployment rate than fiscal 2017 and assessed valuation rebounding after two years of declines. The concerning aspects of the economy include a steady population erosion continuing for the foreseeable future, alongside declines in available jobs.

Recent multi-year budget cuts to the University of Alaska from the governor's office could exacerbate both job and population losses as the university system aligns its expenditures with future revenues. The municipality is also home to a large seaport and one of the world's busiest cargo airports. Current federal trade policies have introduced some uncertainty regarding both growth and employment figures for both the sea and airport, along with the businesses throughout the Anchorage economy that support both ports.
Revenue Framework

The municipality's revenue structure is dominated by stable property taxes. The municipality also collects relatively modest hotel, cigarette, marijuana and motor vehicle taxes, as well as typical fees for services, permit and fine revenues. The municipality does not levy a sales tax.

Fitch expects the municipality to experience gradual revenue growth in line with inflation over the medium term, but the municipality has experienced revenue weakness in recent years. Revenues fell between fiscal years 2014 and 2016, including a 3.9% drop in fiscal 2016 driven by a sharp drop in intergovernmental revenues from the oil-dependent state of Alaska (rated AA/Stable by Fitch). Fiscal 2018 figures indicate state aid accounted for approximately 2.7% of general fund revenues, providing some vulnerability to future cuts. The municipality has taken steps to diversify its revenue streams, which has seen positive results through both increased revenues and reduction in state aid as a percentage of general fund revenues.

Municipality policymakers have a moderate degree of independent legal ability to raise revenues. The municipal charter includes a tax limitation, without a vote of the people, that generally limits tax levy increases to the rate of inflation and population growth. The levy-based tax limitation provides some protection in downturns because policymakers can adjust tax rates higher to maintain the value of the levy as long as they stay within the charter limit. However, policymakers' legal ability to raise revenues is largely limited to raising fees, fines and permit revenues that are too small a part of the budget to completely offset the municipality's revenue volatility. The assembly may also increase the dividend paid to the general fund by the $162 million Municipality of Anchorage Trust (permanent fund) to as high as 5%; the dividend was 4.25% in the most recent budget year. The dividend equaled about 0.9% of fiscal 2018 revenues.

The municipality has taken steps to diversify and increase its revenues during the recent period of economic weakness. It implemented a fuel excise tax in March 2018, and voters have approved the sale of the municipal electric utility. The municipality has agreed to sell the utility to a neighboring electrical cooperative for about $1 billion. According to management, the municipality is expected to receive an upfront payment of about $767.8 million, of which approximately $541 million will be used to retire electric revenue obligations.

Additionally, the municipality will receive approximately $240 million (present value) in annual payments over 50 years. The increase to available revenues for the municipality could result in use of the upfront payment to repay the CIVICVentures revenue bonds, freeing up annual hotel taxes or to increase the permanent fund, which in turn would increase the allowable divided to the municipality. The deal requires regulatory approval but could noticeably improve near-term financial performance of the municipality if approved.

Expenditure Framework

The municipality is a full-service consolidated city and borough. Labor costs for police and firefighters are its primary expenditures aside from a pass-through of property taxes collected on behalf of a component unit school district.

Spending growth is expected to match revenue growth over time, assuming an inflation-like increase in revenues. The main cost pressures are related to health care costs, but overall compensation costs track inflation well. Pension and OPEB costs should grow at about the rate of payroll growth since, pursuant to statute, the state of Alaska pays PERS contributions in excess of 22% of payrolls on behalf of local governments, limiting the amount of growth in retiree cost growth that fall to local governments. PERS also includes other post-employment benefits (OPEBs) for covered employees.
Expenditure flexibility is solid. The relatively fixed carrying cost of debt, pensions and OPEBs is low-to-moderate at approximately 11% of government spending in fiscal 2018. The labor negotiating framework is somewhat complicated with the two largest public safety unions subject to binding arbitration provisions; however, management retains solid control of headcount, allowing spending adjustments when needed.

**Long-Term Liability Burden**

The long-term liability burden is moderate at about 10% of personal income. Direct debt makes up about 62% of the burden with the vast majority in the form of unlimited tax GO bonds. The municipality and school district will have about $219 million of unused voter bond authorization remaining after the current deal. Issuance on this scale would not materially change the liability burden.

About 38% of the liability burden reflects unfunded pension liabilities, which are about $704 million adjusted for Fitch's standard 6% rate of return assumption. The municipality provides pensions through the Alaska Public Employees' Retirement System (PERS) and three local public safety pension plans. All of the plans are closed to new entrants. As noted above, the state is responsible for PERS liabilities in excess of local government payments of 22% of payroll, limiting the amount of PERS unfunded liabilities that fall to local governments.

**Operating Performance**

The municipality has extraordinary gap-closing capacity and is likely to maintain a high level of fundamental financial flexibility through downturns. For details, see Scenario Analysis, page 6.

The municipality's reserve safety margin is quite solid relative to the 1% decline in revenues assumed in the Fitch Analytical Sensitivity Tool (FAST). A recent revenue contraction in fiscal 2016 appears to be more severe than the typical recession for Anchorage with sizable cuts in state aid weighing on revenues, and the municipality had a budget deficit equal to 2.7% of general fund spending and transfers out in 2016. The municipality restored fiscal balance in fiscal 2018 though any future fiscal imbalances could put downward pressure on the rating.

Inherent budget flexibility is assessed to be midrange, reflecting solid expenditure flexibility and moderate independent legal ability to raise revenues. Fitch expects the municipality to use a combination of fund balance spending, manageable expenditure cuts and small revenue increases to manage through stress periods and expects unrestricted reserves to remain above the 5% threshold for a 'aaa' financial resilience assessment.

Budget management in times of recovery is strong, with prompt rebuilding of the municipality's reserve safety margin. Sound budgeting practices include full funding of actuarially required pension contributions, efforts to prefund OPEBs and detailed long-term financial planning with frequent course corrections to restore long-term structural budget balance.

**Dedicated Tax Key Rating Drivers**

The 'AA-' rating on hotel tax revenue bonds reflects solid growth prospects for revenues, a strong coverage cushion relative to expected revenue volatility and expectations that the municipality will not leverage the revenue stream to the maximum extent allowed under the indenture; the additional bonds test is based on a 1.75x coverage requirement of maximum annual debt service (MADS).
Dedicated Tax Credit Profile

The municipality's total hotel tax rate is 12%. Voters authorized a four-percentage point increase in the city's room tax to 12% and the issuance of revenue bonds to construct a new convention center in April 2005. The bonds are primarily payable from the new 4% convention center room tax. The Anchorage Convention and Visitor's Bureau (ACVB) has also pledged 66.25% of the four percentage points it receives from the municipality to promote tourism. The municipality pledges $500,000 per year from its remaining four percentage points of room tax to be increased or decreased each year by the percentage change in total hotel taxes collected for the prior year. The ACVB pledges another $500,000 from its remaining room-tax revenues likewise to be increased or decreased each year by the percentage change in total hotel taxes collected for the prior year. Pledged revenues equal slightly more than 70% of collected room taxes.

Growth prospects for revenues are solid. Hotel tax revenues have grown at a 2.3% compound annual rate over the past decade, exceeding inflation. The convention and visitor industry is an important part of the Anchorage economy, and the municipality proactively markets itself to regional, national and international audiences. As the hub for Alaska's many services and transportation, Anchorage is also a leading visitor destination for in-state tourist and commercial travel.

To evaluate the sensitivity of the dedicated hotel tax revenue stream to cyclical decline, Fitch analyzes the degree of coverage cushion that current revenues provide at existing MADS. Fitch measures the coverage relative to both recessionary revenue declines via FAST, using the same 1% decline in GDP economic scenario used in the IDR framework and the largest decline in revenues over the period covered by the revenue sensitivity analysis.

The FAST model generates a 7.4% decline in pledged revenues in Anchorage's hotel taxes in recession, reflecting a high degree of economic cyclicality in the revenue stream. The largest cumulative decline in the 20-year revenue history used for Anchorage was a steep 17.4% decline in 2009. Fitch's rating assumes CIVICVentures will not leverage hotel tax beyond 2.0x MADS, roughly reflecting past practice. At 2.0x MADS coverage, the structure would allow a 50% decline in revenues before reaching 1.0x debt service coverage. The 50% coverage cushion is 6.8x the recessionary decline scenario produced by the FAST model and 2.9x the largest consecutive decline in the analyzed revenue history, each in excess of the coverage multiples necessary to support a 'aa' level of pledged revenue resilience.

The concentration within the taxpayers weighs on Fitch's assessment. In fiscal 2018, the top 10 taxpayers accounted for 50% of total room tax revenues.
Anchorage (AK)

Scenario Analysis

The municipality has extraordinary gap-closing capacity and is likely to maintain a high level of fundamental financial flexibility through downturns. The municipality's unrestricted general fund balance equaled a solid $59.3 million or 8.3% of total expenditures and transfers out at the end of fiscal 2018 and 12.7% of spending excluding educational expenditures, which represent a pass through of property tax revenues on behalf of the Anchorage School District. The district has its own budgets, financial statements and reserves.

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch’s downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.
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