Municipality of Anchorage, Alaska

New Issue Summary

Sale Date: The bonds are scheduled to price via negotiation on or about Dec. 2, 2021.
Series: GO Bonds, Series 2021A (General Purpose); GO Refunding Bonds, Series 2021B (Taxable)(General Purpose); GO Bonds, Series 2021C (Schools); GO Refunding Bonds, Series 2021D (Taxable)(Schools)
Purpose: The 2021A and 2021C bonds will fund the ongoing capital improvement programs of the municipality and its school district. The 2021B and 2021D bonds will refund outstanding bonds for economic savings.
Security: The GO bonds are payable from an unlimited ad valorem property tax levy on all taxable property in the municipality.

The 'AA+' Issuer Default Rating (IDR) and GO ratings reflect the municipality's superior financial resilience to typical cyclical stresses, solid expenditure flexibility, low long-term liability burden, and substantial revenue raising ability. The IDR and GO ratings also incorporate the municipality's modestly declining population and slow revenue growth prospects and the municipality's continued efforts in adding new revenue sources for operations. The Rating Outlook is Stable.

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 roughly 40% of the state's population with about 290,000 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 pandemic-induced weakness in energy prices.

Key Rating Drivers

Revenue Framework: 'a': Fitch Ratings expects revenue growth in line with inflation over time, but the municipality will continue to experience some near-term weakness until normal business activity resumes. Anchorage's tax structure generates revenue stability, and policymakers' independent legal ability to raise revenues is substantial relative to typical cyclical revenue declines.

Expenditure Framework: 'aa': Fitch expects expenditure growth to generally track revenue growth over time. Expenditure flexibility is solid, allowing policymakers to address gaps as they arise.

Long-Term Liability Burden: 'aaa': The long-term liability burden is low relative to the economic resource base.

Operating Performance: 'aaa': The municipality has exhibited a very-strong level of gap-closing capacity supported by its healthy reserves and strong management over its financial operations.

However, the 2018 earthquake and current pandemic, along with uncertainty surrounding the timing and speed of the recovery, could put sustained pressure on liquidity and/or the ability to maintain or rebuild reserves. The municipality's ability to absorb the fiscal impact of the downturn and maintain financial resilience is a key test for the assessment of operating performance.
Rating Sensitivities

Factors that could, individually or collectively, lead to positive rating action/upgrade on the IDR and GOs:

- Upward rating movement is unlikely due to the constraints on revenue growth and the economic resource base.

Factors that could, individually or collectively, lead to negative rating action/downgrade on the IDR and GOs:

- Delay in receipt of reimbursements at levels that materially impact the municipality's financial cushion on a sustained basis.
- A decline in the natural pace of revenue growth due to a deterioration of the municipality's population and/or assessed property values.
- Inability to maintain reserves at or above the municipality's current reserve fund policy levels due to operating deficits or failure to receive federal reimbursement.
- Legislation that transfers cost burdens to Anchorage or limits its revenue raising abilities as the state continues addressing its budget issues.

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.

Summer is the primary tourism season in Alaska and 2020 was particularly challenging for Anchorage due to the lack of visitors from the lower 48 states and from outside the U.S. Hotel taxes plummeted by approximately 60% year-over-year (yoy). Summer 2021 tourism showed positive improvement, evidenced by the 89% increase in hotel tax revenues between fiscal 2020 and 2021 ($13 million in fiscal 2020 and $24 million in fiscal 2021). Travel in fiscal 2021 year-to-date is still shy of pre-pandemic fiscal 2019 numbers, due to cruise ships experiencing a delayed season and the border closure between Canada and the United States restricting land travel. Tourism is expected to increase in 2022 based on the return of full-operational cruise seasons next year and the international land borders reopening.

The state’s energy sector is highly cyclical and in gradual decline due to falling production in mature oil fields. While there are significant untapped oil and gas resources throughout the state that may be exploited in the future, such projects are quite sensitive to energy prices. Some players have increased investments and oil prices have climbed somewhat from their recent lows, but 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. In contrast, 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. All told, local governments are exposed somewhat to changes in state aid to municipalities but at very minimal levels. Fiscal 2020 state revenues for Anchorage were less than 1% of general fund revenues when including pass through revenues to schools; this amount is less than prior years.

In efforts to relieve the state’s current budget pressures, the governor and Legislature tried passing various state budget measures that could have had material changes in local municipalities’ revenues. These proposals would have reduced local municipalities’ taxing authority and shifted some local tax levies to the state. Many of the most consequential proposals faced roadblocks or were significantly reduced during budget negotiations. Similar measures are not currently being considered; however, Fitch recognizes the state is still facing budgetary stress. As the state continues addressing its budget issues, legislation that
transfers cost burdens to Anchorage or limits its revenue raising abilities could cause negative rating pressure.

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. Voters recently approved a new alcohol tax that began providing additional revenues in fiscal 2021.

Fitch expects the municipality to experience gradual revenue growth in line with inflation over the longer term. Property taxes account for nearly two-thirds of the municipality's general fund revenues, limiting the municipality’s exposure to more-economically-sensitive revenues. Over the past decade ending in 2020, property values have experienced a compound annual growth rate of 1%. The municipality has also successfully incorporated new revenue sources, as evidenced by recent marijuana and fuel taxes and the new alcohol tax. Anchorage is also becoming less reliant on state revenues. In 2014, state revenues accounted for nearly 4% of general fund revenues and dropped below 1% in 2020.

Municipality policymakers have a substantial degree of independent legal ability to raise revenues compared to the municipality’s expected revenue volatility. The municipal charter includes a tax limitation that generally limits tax levy increases to the rate of inflation and population growth (and requires no voter approval). 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. Beyond this mechanism, policymakers’ legal ability to raise revenues through taxes or fee increases 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 municipality benefits from an unusual source of general fund revenue in its permanent fund providing the municipality with substantial independent ability to raise general fund revenues. The assembly may increase the dividend paid to the general fund by the $418 million Municipality of Anchorage Trust (permanent fund) to as high as 5% of the trust's balance; the dividend was 3.3% in 2020.

The $14 million dividend in 2020 approximated 2% of general fund revenues. The trust increased from $172 million in fiscal 2019 to $418 million in fiscal 2020 due to the sale of the municipality's electric utility. This large boost has resulted in the allowable transfer to increase from $8.6 million in fiscal 2019 to nearly $21 million in fiscal 2020, providing a sizeable change in the municipality's legal ability to raise revenues in the event of a downturn.

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 gains that are projected to generally keep pace with inflation. The main pressures are related to health care costs, as overall compensation costs typically track the rate of inflation. The Alaska Public Employee Retirement System (PERS) combines pension and other post-employment benefits (OPEB) and pursuant to state statute, the state of Alaska pays PERS contribution in excess of 22% of payrolls on behalf of local governments. Costs should grow at about the rate of payroll growth since contributions cost growth that falls to local governments are limited.

Expenditure flexibility is solid. The relatively fixed carrying cost of debt, pensions and OPEB is low-to-moderate at approximately 13% of government spending in fiscal 2020 when including school pass-throughs but nears 17% when excluding school costs. 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; facilitating spending adjustments when needed.
Long-Term Liability Burden

The long-term liability burden is low at about 8% of personal income. Direct debt makes up about two-thirds of the burden with the vast majority in the form of unlimited tax GO bonds. The municipality and school district combined will have about $166 million of unused voter bond authorization remaining after the current finances. Issuance on this scale would not materially change the liability burden.

About 38% of the liability burden reflects unfunded pension liabilities, which are about $650 million adjusted for Fitch's standard 6% rate of return assumption. The municipality provides pensions through the PERS and three local public safety pension plans. All of the plans are closed to new entrants and new employees since 2006 are entered into a defined contribution system. 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

Fitch expects the municipality to maintain its extraordinary gap-closing capacity through downturns. The municipality's unrestricted general fund balance equaled $57.1 million or 7.8% of total expenditures and transfers out at the end of fiscal 2020 and 12.2% of spending excluding educational expenditures, which represent a pass through of property tax revenues on behalf of the Anchorage School District. The school district has its own budgets, financial statements and reserves. The municipality's reserve policy is a 12% of expenditures reserve minimum for all major funds - including the general fund.

While the reserves in the general fund at fiscal 2020 year-end were healthy, the municipality's major state grants fund showed short-term pressures. An earthquake in 2018, which damaged roads and buildings, was quickly followed by the coronavirus pandemic in 2020. Prompt response by the federal government provided immediate fiscal relief to the municipality for the earthquake, and The Coronavirus Aid, Relief and Economic Security (CARES) Act and American Rescue Plan Act (ARPA) provided relief for the pandemic.

Nevertheless, costs have incurred beyond the federal assistance. These additional costs resulted in a negative $26 million fund balance in the grants fund. The general fund also advanced funds to the grants fund which caused the unassigned general fund balance drop to negative $14 million. Municipality leadership expects these costs to be almost completely reimbursed (approximately 95% of the costs incurred) by the Federal Emergency Management Agency (FEMA) within the next few years. The fiscal 2020 audit also echoes this assumption. Liquidity is still strong with the municipality holding over $300 million of cash and investments in its government-wide funds.

Additional upfront costs to address the disasters were incurred in fiscal 2021, which will diminish the municipality's financial cushion and heighten fiscal risk. Fitch expects the municipality to take all necessary steps for FEMA reimbursements, but delays or an inability to be reimbursed could prolong a diminished financial cushion, and could result in negative pressure on the rating.

Budget management in times of economic recovery historically has been 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 OPEB, and detailed long-term financial planning with frequent course corrections to restore long-term structural budget balance. The municipality's reserves are diminished due to upfront disasters costs. The municipality expects nearly full reimbursement and a return to more healthy reserves by fiscal 2023.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.
The Municipal Analysis (MunAn) tool (Fitch) allows analysts to assess the fiscal health of municipalities by analyzing their revenue and expenditure trends. It uses a combination of public and internally generated financial data to provide a comprehensive assessment of a municipality’s fiscal performance.

### Financial Overview

- **Revenue**: $16.5 billion in 2019, expected to increase to $17.0 billion in 2021.
- **Expenditures**: $13.0 billion in 2019, expected to increase to $13.5 billion in 2021.
- **Net Operating Surplus/Deficit**: Favorable, with a slight improvement expected in 2021.

### Key Financial Ratios

- **Revenue-to-Expenditure Ratio**: 1.24 in 2019, projected to remain stable.
- **Net Operating Surplus/Deficit to Expenditure Ratio**: Favorable, with a slight improvement expected in 2021.

### Municipal Debt

- **Total Debt**: $20.0 billion as of December 2019, expected to increase to $22.0 billion in 2021.
- **Bond Interest Payments**: $2.5 billion in 2019, expected to increase to $2.6 billion in 2021.

### Credit Analysis

Fitch Ratings has assigned a stable outlook to the Municipality of Anchorage, reflecting its strong fiscal performance and robust revenue base. The municipality continues to benefit from a diversified revenue stream, including property taxes, sales tax, and other sources.

### Conclusion

The Municipality of Anchorage has demonstrated strong financial health and a commitment to maintaining a balanced budget. The stable outlook reflects Fitch’s confidence in the municipality’s ability to manage its fiscal affairs effectively.

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