

# RatingsDirect®

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**Summary:**

## Anchorage Municipality, Alaska; Appropriations; General Obligation

**Primary Credit Analyst:**

Alex Louie, Centennial 303-721-4559; alex.louie@spglobal.com

**Secondary Contact:**

Karolina Norris, Farmers Branch 972-367-3341; Karolina.Norris@spglobal.com

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### Credit Profile

US\$77.625 mil GO rfdg bnds (taxable) (schools) ser 2020F dtd 08/19/2020 due 08/01/2034		
<i>Long Term Rating</i>	AAA/Stable	New
US\$56.0 mil GO bnds (schools) ser 2020E dtd 08/19/2020 due 04/01/2040		
<i>Long Term Rating</i>	AAA/Stable	New
US\$43.705 mil GO rfdg bnds (taxable) (gen purp) ser 2020C dtd 08/19/2020 due 08/01/2034		
<i>Long Term Rating</i>	AAA/Stable	New
US\$40.445 mil GO bnds (gen purp) ser 2020A dtd 08/19/2020 due 04/01/2040		
<i>Long Term Rating</i>	AAA/Stable	New
US\$13.965 mil GO rfdg bnds (gen purp) ser 2020D dtd 11/04/2020 due 04/01/2031		
<i>Long Term Rating</i>	AAA/Stable	New
US\$1.77 mil GO rfdg bnds (gen purp) ser 2020B dtd 08/19/2020 due 04/01/2028		
<i>Long Term Rating</i>	AAA/Stable	New

## Rating Action

S&P Global Ratings assigned its 'AAA' rating to Anchorage Municipality, Alaska's series 2020 general obligation (GO) and GO refunding bonds. At the same time, we affirmed our 'AAA' long-term rating and underlying rating (SPUR) on Anchorage's GO debt outstanding and our 'AA+' rating on the municipality's certificates of participation outstanding. The outlook is stable.

## Security and Use of Proceeds

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 has agreed to budget and appropriate for COP 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 2020 issuances will fund a variety of continuing capital projects in Anchorage, capital projects for Anchorage schools and refund the municipality's series 2010C, 2011A, 2012A, and 2014A debt.

## **Credit Overview**

The stable outlook reflects our view that the municipality will restore reserves after a one time decline due to earthquake damages. Although our outlook periods are usually two years, we see significant risks related to the COVID-19 pandemic, and Anchorage is no exception, given slowly declining economic metrics and revenue declines. Management expects significant declines in hotel and rental car tax revenues, but these sources of revenue consist of a small portion of overall revenues. Property tax collections are similar to last year, and make up 70% of revenues, providing some stability during the pandemic. The municipality has routinely explored various sources of revenue either through increased taxes or increasing fees for services and recently passed a 5% alcohol tax, scheduled to take effect in February 2021, bring approximately \$11 million in revenue a year. We believe that the Alaska state budget shortfall, driven by losses in oil and gas revenues, could affect Anchorage. While the municipality receives little direct revenue from the state, Alaska provides support in the form of pension contributions, and school debt reimbursement. Cuts to these areas could force the municipality to increase pension contributions, or increase tax rates for school bond reimbursements. Finally, the pending sale of the utility will likely strengthen the MOA trust and significantly reduce the municipality's debt burden when the deal closes later in 2020. Ultimately, while we see numerous risks for the municipality's finances, we believe that the municipality's strong management, expected fund balance infusions from FEMA reimbursements and CARES act funding, provide sufficient stability for Anchorage in the near term.

## **Stable Outlook**

### **Downside scenario**

We could lower the ratings if the municipality's financial performance in fiscal 2020 does not show a restoration of reserves as expected. We may also lower the rating if we believe that the municipality is having difficulty balancing its budget in the context of weakening economic conditions or rising pension contribution requirements.

The rating reflects our view of Anchorage's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2019, which closed with a slight operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2019;
- Strong budgetary flexibility, with an available fund balance in fiscal 2019 of 9.9% of operating expenditures;
- Very strong liquidity, with total government available cash at 74.7% of total governmental fund expenditures and 5.6x governmental debt service, and access to external liquidity we consider exceptional;
- Adequate debt and contingent liability position, with debt service carrying charges at 13.4% of expenditures and net direct debt that is 143.5% of total governmental fund revenue, as well as rapid amortization, with 66.0% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

## **Environmental, Social, and Governance Factors**

The rating also incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider social risk factors. Although the scope of economic and financial challenges posed by the pandemic remains unknown, we believe a prolonged disruption could weaken the municipality's local economy.

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 other peers, given the gradual population decline, which we believe could materially affect the municipalities 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.

### **Very strong economy**

We consider Anchorage Municipality's economy very strong. The municipality, with an estimated population of 298,979, is located in the Anchorage MSA, which we consider to be broad and diverse. The municipality has a projected per capita effective buying income of 127% of the national level and per capita market value of \$116,098. Overall, the municipality's market value was stable over the past year at \$34.7 billion in 2020.

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.

The municipality's population has been slightly declining, with comparable state estimates for the summer showing declines in the past three years through 2020 after more than a decade of slow growth. Population has decreased by 10,000 residents in 2020 to approximately 290,000. At this time it does not appear that the trend will reverse anytime soon, as management states that the municipality is losing residents to other places in the U.S.

Despite the population decline, assessed value is projected to remain stable in fiscal 2020 due to new construction. Fiscal 2019 building permit values have rebounded after four years of decline from fiscal 2014 to 2018, and management expects fiscal 2020 permits to remain at least stable. New projects underway include two new hotels, although construction is delayed due to the COVID-19 pandemic. Residential construction continues in the area with multiple developments in progress including a downtown housing development. In addition, management notes that activity at the Port of Anchorage remains stable, with goods continuing to flow through the port despite the COVID-19 pandemic.

Like many other municipalities, Anchorage has seen a spike in unemployment, although at 12.3 percent, the municipality is below the United States average. Over the past five years, Anchorage has experienced steady employment declines, with the biggest declines in employment coming in the health care, tourism, and construction

sectors. Our income and market value per capita metrics indicate that the municipality has seen a slow decline in income and wealth metrics, but is still well within our scoring metric at very strong. Any change in our economic scoring is not likely in the near term.

We believe that the gradual economic recovery from May faces increased challenges due to the continued spread of COVID-19. For more information, please read our report titled "U.S. Real –Time Economic Data Suggest Hopeful Signs Of A Recovery Could Be Short-Lived" published on RatingsDirect on July 16, 2020. With reemergence of virus transmission rates nationally, uncertainty is elevated again; high frequency real-time indicators of activity suggest momentum may be losing teams, with mobility, in particular, beginning to weaken.

The municipality has experienced a relatively low number of deaths, although cases continue to increase. Management reports they were proactive in addressing the pandemic stating they were one of the first localities to enact shutdown orders. If other states institute closing measures again, there is a possibility that the COVID-19 recession could worsen. For Anchorage, we believe the biggest risk is for the oil and gas sector as well as tourism. Demand for oil products continues to struggle to recover after COVID-19, and although Anchorage derives a very small portion of its revenue from the state and many oil field employees live outside of Alaska, some oil field workers live in Anchorage, which could impact local spending. Tourism was a growing portion of Anchorage's economy, and the COVID-19 pandemic has decreased tourism activity in the municipality. In summary, population and employment declines are a risk for the municipality, especially if tourism continues to suffer due to the pandemic. However, a rebound in building permits, and stable activity indicate portions of the economy remain stable.

### **Strong management**

We view the municipality's management as very strong, with strong financial policies and practices under our Financial Management Assessment methodology, indicating financial practices are strong, well embedded, and likely sustainable.

The municipality's financial management policies and practices include its:

- 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; and
- Formal minimum reserve policy of 10% of expenditures to provide comfort to the credit markets and an additional 2%-3% reserve for emergencies. We note that management addressed the decline in fund balance with the council

and signed a resolution acknowledging they were not meeting the reserve target. Management expects to be in compliance with the reserve target in fiscal 2020.

### **Adequate budgetary performance**

Anchorage Municipality's budgetary performance is adequate in our opinion. The municipality had slight deficit operating results in the general fund of negative 1.3% of expenditures, but a surplus result across all governmental funds of 5.8% in fiscal 2019. Our assessment accounts for the fact that we expect budgetary results could improve from 2019 results in the near term. In addition our forward-looking opinion of adequate budgetary performance reflects uncertainty concerning the effect, and duration, of COVID-19 and the related recession on the municipality.

Our analysis of the municipality's general fund and total governmental fund results are inclusive of our internal adjustments that remove property tax pass-throughs for its school district enterprise, one-time uses, and bond-related uses within the two funds. It also includes an adjustment for annual transfers from the MOA trust fund into the general fund.

Tourism revenue in Anchorage has seen shortfalls in fiscal 2020, and there is significant uncertainty with the state budget which could affect school expenditures; however property tax, which is the majority of the municipality's revenues remain stable. 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. Management expects a shortfall of \$16 million from rental car and hotel taxes but these sources are a relatively small portion of Anchorage's revenue mix, with the municipality reporting \$89 million in other tax receipts on \$795 million in revenue in fiscal 2019. Officials report that property taxes, which comprise 70% of revenues are stable, with delinquencies at similar levels to last year.

Management continues to explore additional revenue sources, and reports some savings in fiscal 2020 due to the pandemic. Officials report the municipality has held expenditures steady during the pandemic, with some savings in fuel and overtime costs. Anchorage voters passed a 5% alcohol beverages retail sales tax, which goes into effect in February 2021, and is expected to bring \$11.8 million in revenue. This is in the addition to the marijuana tax which went into effect in fiscal 2018 and fuel excise taxes, which went into effect in fiscal 2018.

In fiscal 2019, the municipality reported balanced results with all transfers included, but showed a significant decline in unassigned fund balance as the municipality continues to deal with damages from a large earthquake as non-spendable fund balances, particularly advances to other funds increased. Officials state that the decline in reserves is due to expenditures related to earthquake repairs, with approximately \$9 million spent from the general fund.

In fiscal 2020, the municipality expects to increase fund balances. Management expects to receive FEMA reimbursements in fiscal 2020 as well as CARES act grant receipts. On June 22nd, Anchorage received \$117 million in federal funding, and will receive additional funding from the state once 80% of the initial grant is spent. The funds are designated for specific purposes, but management expects to charge these funds to public safety, and given that Anchorage spends nearly \$170 million on public safety, officials believe these grants will offset some of their costs, allowing the municipality to retain more fund balance.

We believe that the municipality has tools at its disposal to navigate the municipality through the COVID-19 pandemic

and challenging economic conditions, given their history in exploring new revenue sources and ability to change tax rates. One time CARES act funding will help management keep operations balanced in the near term, but we believe that volatility remains. In particular we believe that financial stress at the state level could materially affect certain assistance Anchorage receives from the state, such as school bond debt reimbursement, and pension contributions.. At this time, management does not have any concrete information on potential budgetary changes.

### **Strong budgetary flexibility**

Anchorage Municipality's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2019 of 9.9% of operating expenditures, or \$47.6 million. 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 support by a large trust fund, which contributes a set percentage each year for operations.

The trust, which dates back to 1999, when it was set up to manage the proceeds of the sale of the municipality's telephone utility, functions as an endowment. In addition to the reserves listed below, the municipality maintains a MOA Trust Fund with a balance of \$171.5 million as of Dec. 31, 2019 which is a significant increase from fiscal 2018 (\$151 million). Each year the municipality can transfer 4.25% out of the fund for operations.

The municipality is expecting a large influx of funds as a result of the sale of the municipality's electric utility. Funds will not be deposited in reserves, but rather will be used to defease debt or be deposited in the MOA trust fund. Voters approved the sale of the municipality's electric utility in April 2018. Officials agreed on the transaction with Chugach Electric Association in October 2018, which is valued at approximately \$1 billion. The closing of the transaction has been delayed due to regulatory approvals, but management believe the deal will close in the 4th quarter 2020. This will result in \$500 million reduction in debt, and a \$229 million deposit in the MOA Trust fund. In recent years, the municipality has transferred between \$6 million to \$6.5 million from the trust fund. The percentage is calculated based on a 20 quarter balance average, but with new funds expected in the trust, management is in conversations with the municipality council to reset the historical lookback period. Management expects to transfer as much as \$11 million a year to the general fund from the trust once the ML&P sale is closed.

Overall, while reserves were affected by the earthquake, management expects reserves to increase significantly in 2020. We believe that the MOA trust also provides additional flexibility, even though the municipality's access to funds is limited.

### **Very strong liquidity**

In our opinion, Anchorage Municipality's liquidity is very strong, with total government available cash at 74.7% of total governmental fund expenditures and 5.6x governmental debt service in 2019. In our view, the municipality has exceptional access to external liquidity if necessary. We believe the municipality has exceptional access to external liquidity if necessary due to frequent debt issuances of a variety of security types during the past 15 years over changing economic cycles. We do not consider the municipality's investments for its operating reserves to be aggressive and management has confirmed that the municipality does not have alternative financing outstanding, which we find can represent a source of contingent liquidity risk.

### **Adequate debt and contingent liability profile**

In our view, Anchorage Municipality's debt and contingent liability profile is adequate. Total governmental fund debt service is 13.4% of total governmental fund expenditures, and net direct debt is 143.5% of total governmental fund revenue. Approximately 66.0% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

We anticipate the municipality will continue a pattern of approximately annual GO debt issuances consistent with a capital plan that calls for \$50 million to \$100 million to be issued each year and existing voter approved GO debt authorizations. In addition, we expect the municipality to continue to issue tax anticipation notes on a yearly basis in order to maintain its investment portfolios. However, we don't anticipate its net direct debt burden significantly increasing relative to its operations or tax base in the near term.

Anchorage Municipality's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 12.8% of total governmental fund expenditures in 2019. Of that amount, 7.5% represented required contributions to pension obligations, and 5.2% represented OPEB payments. The municipality made its full annual required pension contribution in 2019.

### **Pension and OPEB**

We consider the municipality's pension a source of potential credit pressure if the state, currently under financial stress, reduces its contributions towards pension plans. The municipality contributes 22% of employee salaries to PERS, while the state funds the residual needed to fully fund the plans' actuarially determined costs. If the state lowers its contributions, we may consider the municipalities' pension contributions large.

Anchorage participates in the following plans:

- Alaskan Public Employees Retirement System (PERS), funded at 63.5% with a net pension liability of \$354 million
- (PERS) Other Post Employment Benefits, unfunded with a net liability of \$114 million

The municipality and its employees participate in three cost-sharing, multiple-employer plans provided by Alaskan Public Employees Retirement System (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 future. With a closed layered 25 year amortization period, we believe the municipality will gradually make progress towards full funding, and 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.

The municipality's OPEB liability consists of lifetime health benefits for one closed group and another fixed monthly contribution for health costs for another closed group. The unfunded actuarial accrued liability for these plans totaled \$114 million as of 2019. According to the fiscal 2019 audit, the municipality recognized a net expense of \$90 million.

## Strong institutional framework

The institutional framework score for Alaska is strong.

Ratings Detail (As Of July 31, 2020)		
Anchorage Municipality certs of part (Taxable) ser 2017 due 7/01/2032		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Anchorage Municipality GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Anchorage Municipality GO bnds		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Anchorage Municipality GO rfdg bnds		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Anchorage Municipality GO (MBIA) (National)		
<i>Unenhanced Rating</i>	AAA(SPUR)/Stable	Affirmed
Anchorage Municipality GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Anchorage Municipality GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Anchorage Municipality GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

Many issues are enhanced by bond insurance.

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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