Municipality of Anchorage, Alaska

New Issue Summary

Sale Date: On or about Aug. 5, 2020 via negotiation.
Series: 2020 GO Bonds, Series A (General Purpose); 2020 GO Refunding Bonds, Series B (General Purpose); 2020 GO Taxable Forward Refunding Bonds, Series C (General Purpose); 2020 GO Refunding Bonds, Series D (General Purpose); 2020 GO Bonds, Series E (Schools); and 2020 Taxable GO Refunding Bonds, Series F (Schools).
Purpose: 2020 series A and E bonds to fund ongoing capital improvement programs of the municipality and its school district. 2020 series B, C, D and F bonds to refund outstanding bonds for economic savings.
Security: GO bonds payable from an unlimited ad valorem property tax levy on all taxable property within 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 and moderate long-term liability burden balanced against a somewhat constrained revenue-raising ability.

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 300,000 residents and produces more than one-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 may experience some near-term weakness until normal business activity resumes. 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 generally track revenue growth over time. 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’; In more typical downturns, the municipality had exhibited a very-strong level of gap-closing capacity supported by healthy reserves and strong management of financial operations. However, the severity of the current downturn, caused both by the decline in the oil industry and the coronavirus pandemic, along with uncertainty over the timing and speed of the recovery, could put sustained pressure on balancing operations. The municipality’s ability to absorb the fiscal impact of the downturn and maintain financial resilience is a key test in assessing 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 concentration of the economy and legal constraints on tax policy.

Outstanding Debt Details on Page 2.

Rating Outlook

Stable

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (March 2020)

Related Research

Fitch Rates Municipality of Anchorage, AK’s $234MM 2020 GO Bonds ‘AA+’, Outlook Stable (July 2020)

Analysts

Graham Schnaars
+1 415 732-5760
graham.schnaars@fitchratings.com

Andrew Ward
+1 415 732-5617
andrew.ward@fitchratings.com
Factors that could, individually or collectively, lead to negative rating action/downgrade on the IDR and GOs:

- An economic contraction extending well into the second half of 2020 or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained and deeper than expected revenue declines and erodes the municipality's gap-closing capacity.
- A shift in some state funding obligations to local governments (due to pandemic-induced economic pressures) that could reduce local taxing authority and place additional expenditure pressure on municipalities, including Anchorage.
- A sustained decline in the natural pace of revenue growth due to a deterioration of the municipality's assessed property values.
- An inability to maintain reserves at or above the municipality's current reserve fund policy levels.

Current Developments

The ongoing outbreak of coronavirus and related government containment measures worldwide create an uncertain global environment for U.S. state and local governments and related entities in the near term. While the municipality’s most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch’s ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as they relate to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in 1H20 at a speed and depth unprecedented since World War II. Sequential recovery is projected to begin from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report entitled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases – Update," published April 29, 2020 on www.fitchratings.com.

Coronavirus Impacts on the Municipality of Anchorage

In March, the municipality underwent shelter-in-place measures that closed non-essential businesses for approximately one month. Subsequent municipal orders have allowed businesses to re-open with varying levels of operating capacity to mitigate the spread of the coronavirus. Unemployment has risen dramatically, reaching 12.3% in May 2020 from about 5.1% at YE19. The hospitality and tourism sectors experienced significant decreases in employment, and municipality management expects large decreases in employment across other sectors as well. The lack of both tourists and business travelers is reflected in the municipality’s hotel tax revenues. Current projections indicate a 65% year-over-year hotel tax revenue loss by the Dec. 31 fiscal year end.

The municipality benefits as a vast majority of its general fund revenues are derived from less economically sensitive sources. Property taxes account for nearly two-thirds of general fund revenues, when excluding the property tax collected by the municipality on behalf of the local school district. There is no general sales tax within the municipality, but other taxes, including tobacco and fuel taxes, account for approximately 16% of general fund revenues. Outside of the hotel tax losses, management projects no changes in the property tax and minimal declines in the various other taxes and revenue sources for government operations in 2020.

In June, the municipality received a first payment of $116 million from the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Two other payments approximating $20 million each are expected later in the year. Municipality management indicates no expectations for external borrowing outside the typical annual short-term borrowing for cash flow purposes. At YE19, the municipality reported $249 million in cash on hand, or about 121 days of government expenses.
The overall economic impacts of the coronavirus pandemic are still evolving for the municipality. If unemployment remains persistently high, foreclosures and deflated property values could lower government revenues if impacts from the pandemic are prolonged. The population has been declining in recent years due to lower oil prices and less work opportunities within the oil industry. The pandemic could exacerbate the outmigration with potential permanent job losses both within and beyond the energy sector. Furthermore, the municipality could face increased spending pressures in both homelessness and nutrition services - two prominent issues for Anchorage even before the pandemic.

Fitch expects the municipality to align its expenditures with potentially lower revenues, as it has done in the past. The municipality has a track record of very strong operating performance through various economic cycles, but its ability to absorb the impacts from the coronavirus pandemic and maintain financial resilience will be tested by the depth and possible lengthy duration of the recession.

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. 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 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.

Local governments are exposed somewhat to changes in state aid to municipalities. Fiscal 2019 state revenues for Anchorage were about $6 million (about 1.3% of general fund revenues when excluding the amount passed through to schools); this amount is less than that of prior years.

To relieve the state's current budget pressures, the governor and Legislature recently proposed various state budget measures that could shift some state funding measures to local municipalities. These proposals could reduce local municipalities' taxing authority. Many of the most consequential proposals faced roadblocks or were significantly reduced during recent budget negotiations. 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 will provide additional revenues beginning in 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 to just 1% in 2019.

Municipality policymakers have a moderate degree of independent legal ability to raise revenues. 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 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 $172 million Municipality of Anchorage Trust (permanent fund) to as high as 5% of the trust’s balance; the dividend was 4.25% in 2019. The $6.5 million dividend in 2019 equaled about 1.4% of general fund revenues.

The municipality has taken steps to diversify and increase its revenues during the recent period of economic weakness. In addition to the recently enacted taxes, voters approved the sale of the municipal electric utility to a neighboring electrical cooperative for about $1 billion. The transaction is expected to close in the fourth quarter of 2020 with an upfront payment of about $768 million. Approximately $500 million will go toward paying down debt and the remaining amount will be placed in the municipality’s trust, providing additional annual funds to be transferred for general government purposes.

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 healthcare costs, as overall compensation costs typically track the rate of inflation. Pension and other post-employment benefit (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. These contributions limit the amount of growth in retiree costs that fall to local governments. PERS also includes OPEB for covered employees.

Expenditure flexibility is solid. The relatively fixed carrying cost of debt, pensions and OPEB is low to moderate at approximately 11% of government spending in 2019. 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 moderately low at about 9% 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 $241 million of unused voter bond authorization remaining after the current issuances. Issuance on this scale would not materially change the liability burden.

About 38% of the liability burden reflects unfunded pension liabilities, which are about $582 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 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
Fitch expects the municipality to maintain its extraordinary gap-closing capacity through the current economic crisis and future downturns. The municipality’s unrestricted general fund balance equaled $47.6 million, or 6.4% of total expenditures and transfers out, at the end of 2019 and 9.3% 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 fund balance at YE19 was below the municipality’s policy of 12% of current year expenditures, absent education funding, but management reports this is due to reimbursement delays from the 2018 earthquake. Fitch expects the municipality to rebuild reserves and adhere to its fund balance policies going forward.
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 fiscal 2020 budget indicates reserve balances returning to the municipality's reserve policy levels. An increase in fund balance could occur but is dependent on CARES Act spending flexibility and pandemic-related costs.

**ESG Considerations**

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - 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.
Municipality of Anchorage (AK)

Scenario Analysis

Reserve Safety Margin in an Unaddressed Stress

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Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. 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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