MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aaa rating to State of Alaska's planned $165 million issuance of Series 2013 General Obligation Bonds

Global Credit Research - 04 Jan 2013

Stable outlook applies to current issue and $610 million of outstanding state debt

ALASKA (STATE OF)
State Governments (including Puerto Rico and US Territories)
AK

Moody's Rating

ISSUE		RATING
General Obligation Bonds, Series 2013B		Aaa
Sale Amount	$153,215,000	
Expected Sale Date	01/15/13	
Rating Description	General Obligation	
General Obligation Bonds, Series 2013A (Taxable Qualified School Construction Bonds - Direct Payment)		Aaa
Sale Amount	$11,945,000	
Expected Sale Date	01/15/13	
Rating Description	General Obligation	

Moody's Outlook

Opinion

NEW YORK, January 04, 2013 --Moody's Investors Service has assigned a Aaa rating and stable outlook to the State of Alaska's planned $165 million of Series 2013 General Obligation Bonds in the two series listed above. The bonds are expected to be priced on January 15 and 16. Proceeds will fund various state education projects. Series B will consist of standard debt that provides tax-exempt interest payments, while the Series A bonds will be issued as taxable Qualified School Construction Bonds (QSCBs). Under the American Recovery and Reinvestment Act of 2009 (ARRA), states and large municipalities were authorized to issue certain amounts of QSCBs, for which the federal government provides either tax credits or interest-subsidy payments. QSCB proceeds will finance design and construction of school facilities. The state will be issuing the bonds as direct-payment interest rate subsidy. Proceeds of the Series B bonds will finance design and construction of library, research and other education-related facilities.

SUMMARY RATING RATIONALE

Alaska's accumulation in recent years of large financial reserves has left it well positioned to manage potential fiscal challenges, supporting the state's Aaa rating. Alaska has benefitted from elevated oil prices and from conservative management of its petroleum-based revenues. Alaska's dependence on oil extraction leaves it vulnerable to both global economic conditions and to oil production logistical factors, but the state's financial reserves should help maintain fiscal strength during the next five to 10 years. During this period, we also expect the state will pursue revenue diversification by facilitating production and shipping of its vast natural-gas resources.

STRENGTHS:

- Very large revenue cushion in Constitutional Budget Reserve Fund (CBRF) and other funds

- History of conservative oil price and production-volume forecasting

- Conservative fiscal practices, highlighted by use of 2008 oil revenue windfall to rebuild CBRF

- Potential to transition over time to natural gas from oil as primary revenue source

- Low debt burden compared to available reserves

CHALLENGES:

- Revenue reliance on North Slope oil production, which is in a long-term decline and subject to price volatility and production disruptions

- Narrow economic base with concentration in government employment sector

- Lack of certain best practices for financial management

- Relatively weak pension funding

DETAILED CREDIT DISCUSSION

HEIGHTENED RESERVE LEVELS REFLECT PRUDENT MANAGEMENT OF OIL REVENUE WINDFALL

Alaska's financial reserves available through legislative action to offset revenue shortfalls amounted to more than $19 billion as of October 31. The total consists primarily of a balance of approximately $10.6 billion in the state's Constitutional Budget Reserve Fund (CBRF) and $5.2 billion in its Statutory Budget Reserve; it excludes amounts appropriated to future-year expenditures. It amounts to more than 30 times the state's general obligation debt ($610 million as of June 30, 2012), and is more than three times proposed fiscal 2014 unrestricted general operating appropriations. These reserve amounts are largely attributable to elevated oil prices in recent years. The state receives about 90% of its general fund unrestricted operating revenue (which excludes federal and certain other revenues) from oil producer royalties, and from taxes on property, production and income. The oil price trajectory - to current levels exceeding $100 per barrel from less than $20 per barrel in early 1999 - has enhanced producer profits and state tax revenues. The surge from $60 per barrel in 2007 to $147 the next year produced a windfall that Alaska used mostly to repay its CBRF for amounts drawn when prices were lower. Of Alaska's $6.9 billion fiscal 2008 surplus, about two thirds was allocated to reserve replenishment. The state also appropriated $694 million to fund future-year expenditures. Based on the state's audited figures for the year ended June 30, 2011, the state had available general fund balances of $13.1 billion, or almost 150% of general fund revenues excluding federal sources. The state's financial reserve build-up contrasted with the reserve depletion that most states experienced in recent years because of the US recession.

RESERVE REPLENISHMENT DEMONSTRATES CONSERVATIVE FISCAL PRACTICES

Alaska's rebuilding of reserves demonstrated conservative fiscal practices supported by legal and constitutional requirements. On an audited basis, combined CBRF and Statutory Budget Reserve Fund balances rose $5.5 billion, or 53%, in the two years ended June 30, 2012. The statutory reserve fund accounted for most of this growth, more than $4 billion. The state can spend from the statutory reserve subject to approvals from the governor and legislature, by a simple majority. The CBRF was created by constitutional amendment in 1990 to serve as a formal rainy-day fund. It receives all of the state's administrative and legal settlements in oil and gas production tax and royalty disputes. Its contents are available for appropriation when revenues fall below prior-year levels, or with legislative approval by a three-fourths majority in each chamber. Advances for operating purposes are treated as loans to the general fund, and must be repaid pursuant to Article IX, Section 17(d) of the state constitution. The fund's $8.3 billion audited balance as of June 30, 2009, represented full repayment of past borrowings, as well as additional settlement payments into the fund. The current $10.6 billion balance includes further settlement payments and investment gains through June 30, 2012.

AVAILABLE RESERVES OFFSET EXPOSURE TO OIL PRICE AND PRODUCTION RISK

Alaska's available reserves provide a significant offset to the oil price and production risks inherent in Alaska's G.O. pledge. Weak global economic conditions or disruption of Alaska's Trans-Alaska Pipeline System, for example, could both impair the state's ability to generate revenue. Nevertheless, the state has built a financial cushion large enough to allow it to manage any of these challenges. Financial reserves may ultimately necessary as oil production volumes fall off and the state transitions to large-scale natural gas production. Using its reserves, Alaska could pay for general fund unrestricted operating expenses for several years with no other revenues. It could pay down total net tax-supported debt and still retain substantial available resources. Further, Alaska could draw on reserves to offset low oil prices or production volumes. Production risks persist, and unexpectedly weak oil output may erode revenues. Environmental challenges oil producers face in Alaska were highlighted by the beaching of a Royal Dutch Shell Plc drilling rig on December 31. This incident is unlikely to have a direct impact on Alaska's oil revenues, because Shell was using the rig as part of an exploratory effort to drill in federal waters. Maintenance issues affecting North Slope oilfields and pipelines, such as the 2006 temporary closure of Prudhoe Bay oilfield, are a more likely source of revenue underperformance. Production at Prudhoe Bay, the state's largest source of oil, fell 19% to 274,000 barrels per day on average in the fiscal year of the 2006 shut-down. The daily average for Prudhoe Bay oil output wound up 17% less than had been projected before the year began. In the first four months of fiscal 2013, state revenues fell about 28%, largely because of oil-field maintenance issues. The Trans-Alaska Pipeline System, which has been functioning since 1977 and ships oil 800 miles from the North Slope to Valdez in south-central Alaska, may become more vulnerable to blockages, particularly as the volume of oil shipped through it declines. The state currently projects a 10-year production decline of about 42%, to 338,500 barrels per day in 2022 from 579,000 in 2012.

PERMANENT FUND FOR OIL REVENUES GREW 50% IN PAST DECADE

The primary repository for the state's oil wealth is the Alaska Permanent Fund, which citizens created by voting in favor of a 1976 constitutional amendment. The fund has increased by about 50% in the past decade and is currently valued at $43.6 billion. It receives both a constitutionally and statutorily defined portion of mineral revenues (lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments, and bonuses) paid to the state. The fund is managed by a state corporation, the Alaska Permanent Fund Corporation, which is overseen by a six-member board of gubernatorial appointees. The fund's principal can be used only for income-producing, eligible investments (as defined by statute) and is not available to pay for state operations. The fund pays annual dividends to qualifying state residents, including children. The dividend is calculated as 10.5% of the past five years' total realized income, though without exceeding 50% of the balance in the fund's Realized Earnings Account (REA). The dividend peaked at $2,069 per person in 2008. Within the permanent fund is the Permanent Fund Earnings Reserve account. This account, which is available for appropriation by the state, represents the Permanent Fund's earnings after dividend distributions and ``inflation-proofing'' payments to the fund. The earnings reserve account's balance was $2.98 billion as October 31.

CONSERVATIVE PRICE AND PRODUCTION FORECASTING REMAINS KEY CREDIT FACTOR

A conservative approach to forecasting oil revenues - with respect to assumptions for both price and production - has long been a key element of Alaska's credit profile. The state's fiscal 2008 windfall was a product of the fact that Alaska's forecast oil price ($82.51 per barrel) was substantially less than the actual, $96.51. Through the past decade, the state's long-range oil price projections have consistently proven conservative. Expectations that the state will continue to provide conservative forecasts support the Aaa rating. For its most recent forecast, issued late last year, the state refined its long-term projection methodology to become even more conservative. The new approach uses risk weighting, meaning that it incorporates probabilities surrounding production levels from individual wells into the forecast. The state notes that over the long term, actual output could exceed projected levels because of technological improvements or production beginning in new areas, which are not included in the forecast. The forecast doesn't assume production from a specified area within the Alaska National Wildlife Refuge or from most of the National Petroleum Reserve-Alaska. In addition, the state is likely to revise its current oil production tax regime to encourage producers to invest in new oil production efforts.

MULTI-YEAR FINANCIAL PLANNING WILL BOLSTER MANAGEMENT STRENGTHS

Alaska's financial management, including its conservative approach to oil forecasting, has led to improved financial strength in recent years. The state has addressed financial management weaknesses by adopting a practice of producing multi-year financial plans with out-year revenue and expenditure forecasts. The state does not use a binding consensus revenue estimating process, although the executive branch publishes comprehensive revenue forecasts twice a year. Alaska annually publishes an inventory of state and local debt, although the document lacks projections of future debt issuance and affordability effects. Strengths in the state's governance profile include the executive's ability to impose midyear spending cuts in response to revenue shortfalls. This statutorily defined power provides an alternative to borrowing from the CBRF. Budget monitoring and control is overseen by the state Department of Administration's Division of Finance. Agencies use a statewide accounting system that allows monitoring and summarization of encumbrances and expenditures. The state has not been subject to fiscal uncertainty caused by voter initiatives, although initiatives are allowed under the constitution.

PENSION FUNDING IS WEAK, BUT STATE HAS CLOSED DEFINED-BENEFIT PLANS

The state has implemented reforms to reduce pension funding needs; including closing the defined benefit pension plans to new members after July 1, 2006. This reform will have long-term benefits, but we expect funding needs for the state's plans to exert fiscal pressure in coming years. The state's two largest plans, the Public Employees Retirement System and the Teachers' Retirement System, had a combined aggregate funded ratio of 60% ratio as of June 30, 2011, including liabilities for pension and other post-employment benefits. The state in 2007 created retiree health benefits trusts.

OUTLOOK

The outlook for Alaska is stable, based on expectations the state will continue to make conservative oil revenue forecasts and plan for the eventual depletion of its oil resources, and that its large budgetary reserves will allow it to withstand short-term production disruptions.

WHAT COULD MOVE THE RATING DOWN

- Sustained oil price level below projection

- Deterioration in output volumes

- Rapid depletion of reserves

- Revision of tax regime projected to erode revenues over an extended period

The principal methodology used in this rating was Moody's State Rating Methodology published in November 2004. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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