State of Alaska
Department of Revenue

Commissioner Bryan Butcher

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The Honorable Joe Thomas
Alaska State Senator
State Capitol, Room 514
Juneau, AK 99801-1182

March 30, 2010

Dear Senator Thomas:

This is in response to your March 8, 2011 letter regarding the proposed legislation, SB 79 and SB 80, intended to facilitate the financing of the Knik Arm Crossing.

Your analysis of the current law is essentially correct in that the Knik Arm Bridge and Toll Authority (KABATA) has no authority to obligate the State of Alaska and that the sole legal recourse of a bondholder of KABATA would be the assets and revenues of KABATA. However, it is likely that rating agencies and investors would take some note of the KABATA project even under the current law. Following is a discussion of two kinds of state support for a capital project and where the provisions of SB 80 fall.

MORAL OBLIGATION

The moral obligation structure is used when a more credit worthy entity wants to lend credit support to a less credit worthy entity. The moral obligation is created by mandating a specific structure in law. Specifically, requiring that a reserve dedicated to the liability be created, that the issuer of the reserve have a reporting requirement to the moral obligor, and that in the event of a deficiency in the reserve that a replenishment must be requested from the moral obligor. By creating this legal structure the moral obligor is inferring to investors that while they are not legally guaranteeing the debt, in the event of a shortfall that there will be an appropriation to replenish. If there is a failure of the moral obligor to replenish a reserve based on a moral obligation there would be negative credit ramification, and reduced access to capital. In essence, a moral obligation authority is creating a contingent liability on the moral obligor's balance sheet.

The State of Alaska currently has $1.17 billion of moral obligation debt that is comprised of about $100 million of Alaska Energy Authority utility revenue bonds, about $400 million of Student Loan Corporation bonds, and about $600 million of Alaska Municipal Bond Bank bonds. There has not been a payment under the moral obligation commitment of the state for any of these programs.

Moral obligation debt levels are monitored by rating analysts that review the state, and do go into the calculus of establishing the state's credit rating. As moral obligation debt is generally self supporting and not legal obligations of the State, it has less impact than more direct borrowing structures. A failure to fund a reserve that was established under moral obligation law and depleted due to payment deficiency would subject the state to negative credit rating action.

STATE SUPPORTED

The State Supported structure is used when the state wants to obligate its balance sheet on a subject to appropriation basis rather than a guaranteed basis. Subject to appropriation commitments are made where the State enters into leases or other contracts that obligate the state to pay on a subject to annual appropriation basis, and that lease or contract commitment is fractionalized and sold to third parties. The State of Alaska has most frequently used this structure for the construction of facilities through the issuance of State of Alaska certificates of participation (COP) or through a conduit as lease revenue bonds. The Alaska Seafood & Food Safety Lab was funded through COP and the Goose Creek Correctional Facility was funded through lease revenue bonds.

The State currently has $1.26 billion of state supported debt that is comprised of about $45 million of COPs, $865 million of school debt reimbursement commitment, $30 million of capital project reimbursement, and $315 million of lease revenue bonds. Payments are made annually appropriated for each of these obligations.

State supported debt levels are monitored by rating analysts that review the state and directly impact the state's credit capacity and rating. A failure to appropriate on state supported debt would be viewed as a default of the State of Alaska and result in credit downgrades and significant impediment to future capital market access.

SB 80

The SB 80 Section 1(a)(5)(B) proposed revision provides that monetary obligations under the partnerships or contracts of the Knik Arm Bridge and Toll Authority (KABATA) are obligations of the state and payable on a subject to appropriation basis. This language, in conjunction with other proposed amendment in SB 80, allow up to $600 million of KABATA bonds as well as an unlimited flexibility for private partner bonds to be issued as state supported debt based on a fractionalization of contract payments that are subject to appropriation obligations of the State of Alaska. If contracts are fractionalized and sold to third party investors, by either KABATA or their private partner, they will directly impact the state's debt capacity and credit. In this instance a failure to pay on the contract by the State of Alaska would result in credit downgrades and significant impediment to future capital market access.
The current authorization in SB 80 should be further defined to eliminate the ability of a private party to securitize monetary obligations of KABATA.

It should be clear that SB 80 is authorizing State of Alaska debt of up to $600 million. There can be acknowledgement of the revenue generating nature of the project and the anticipated self sufficiency that is anticipated based on expert analysis, but a firm recognition that the bill as drafted creates a direct line to the State of Alaska's balance sheet for the $600 million of KABATA bonds and unlimited authority for a private partner's bonds is important.

Finally, you asked about my confidence in the revenue projections and financial analysis provided by KABATA in its March 1 TIFIA letter of interest. KABATA has retained CITI, one of the largest and most successful financial services firms in the world, especially as it relates to government financing of infrastructure projects, to develop its financial models. KABATA retained Wilbur Smith, a firm that has advised on many successful projects to do its traffic and toll models. I am confident that the revenue projections and financial analysis are objective and done to the highest of professional standards. This is the type of work that will be accepted and relied upon by the institutional investors that may be interested in financing this project.

Sincerely,

Bryan Butcher
Commissioner