

FITCH RATES ALASKA MUNICIPAL BOND BANK AUTHORITY'S \$103MM GOS 'AA'; OUTLOOK NEGATIVE

Fitch Ratings-New York-14 February 2017: Fitch Ratings has assigned a 'AA-' rating to approximately \$102.5 million of Alaska Municipal Bond Bank Authority (MBBA; bond bank) master resolution general obligation (GO) bonds (2016 Master Resolution), series 2017A.

The bonds are expected to sell via negotiation on or about Feb. 28, 2017.

The Rating Outlook is Negative.

SECURITY

The bonds are general obligations of the bond bank, for which the state will maintain an annual standing appropriation of state general fund resources to replenish the bonds' reserve fund in the event of borrower default.

KEY RATING DRIVERS

MULTIPLE LAYERS OF SECURITY SUPPORT PROGRAM: The MBBA's obligations under the 2016 resolution are supported by multiple levels of bond bank and state support. Foremost among these is the state's inclusion as part of its annual debt service appropriation, an appropriation for reserve fund replenishment in the event of a draw related to default by a participating regional health care organization (borrower or RHO). Other security provisions include the state's statutory moral obligation, borrower reserve funds, and access to unrestricted assets of the bond bank held in the custodian account.

PROVEN STATE SUPPORT AND STRONG REPAYMENT HISTORY: The bond bank's programs have a solid history of debt repayment, and the state of Alaska has a demonstrated history of support for and involvement with the bond bank. The bond bank has consistently worked with the state to strengthen bondholder protections while achieving its programmatic goals. The state's own resources remain substantial despite recent drawdowns to fund financial operations that have been stressed by a prolonged period of low crude oil prices.

PERMITTED USE OF SURETY POLICIES FOR BOND BANK RESERVE FUND: The permitted use of surety policies for the 2016 resolution debt service reserve fund requirement, weakens the link between the standing appropriation to replenish the reserve fund and could require draws upon other funds, such as the MBBA's custodial account, if the surety provider does not perform. The bond bank exercised this option with the first issuance under this resolution while bond proceeds will fund the reserve requirement for the current issue. This results in a two-notch distinction from the state's 'AA+' Issuer Default Rating (IDR).

RATING SENSITIVITIES

LINKAGE TO STATE OF ALASKA: The rating is sensitive to the strong continued oversight of the MBBA and the maintenance of the custodial account. The rating is also sensitive to movement in the state's IDR, to which it is linked.

NEGATIVE OUTLOOK: Failure to enact measures to improve fiscal balance will result in negative action on the state's IDR and linked ratings.

CREDIT PROFILE

The 'AA-' rating is based on the state's commitment to maintain an annual standing appropriation of general funds for program reserve fund replenishment.

STRONG BOND BANK SECURITY PROVISIONS

GO bonds issued under the 2016 resolution incorporate multiple layers of security on both the borrower level and state level. Issuance requires a borrower's revenue pledge and the bond bank has typically required a borrower reserve for revenue bonds. RHOs must demonstrate project essentiality and ability to repay in order to access financing, and additionally, amendments to the bond bank act require a direct financial benefit to the state and an increase in the regional quality of care for financing the capital improvement.

A program reserve fund is backed by a moral obligation of the state, created by state statute, requiring establishment of a reserve and requiring that the bond bank seek a general fund appropriation in the event of a borrower's payment default. This pledge is strengthened by the bond bank's commitment to seek an annual standing appropriation for these bonds and the state's consistent practice of including this appropriation in all enacted budgets since 2009. The enacted budget for fiscal 2017 and governor's proposed budget for fiscal 2018 include this appropriation.

The bond bank's program reserve fund for the 2016 resolution bonds is set at either maximum annual debt service, 10% of par, or average annual debt service. This reserve fund will be separate and apart from reserves established under the 2005 and the 2010 bond resolutions (rated 'AA' and 'AA-', respectively). Surety policies are permitted under the resolution and the bond bank applied that option for its first issue under the 2016 resolution while bond proceeds will fund the reserve requirement on this second issue. Failure of a surety could lead to insufficient time for the state to make the appropriation for debt service. However, in advance of a required state appropriation, the bond bank could access other resources, such as the custodian account, to cover debt service payments, although they are not specifically pledged to bondholders. Fitch believes that procedures for notification of borrower delinquencies that occur well in advance of debt service payments and strong bond bank oversight largely offset this concern.

The custodian account, bolstered by recent state deposits, prior reserve releases, and funded at approximately \$11.5 million as of June 30, 2016, is expected to be maintained at this approximate level in future years, although direct loans by the bond bank and deposits to reserve funds may diminish the custodian account balance. The bond bank reports a policy goal of maintaining a minimum of \$5 million in this account.

BROADENING OF BOND BANK SCOPE

The bond bank was established in 1975 to provide access to low-cost capital financing for Alaska local governments. The bond bank's limit for total bonds outstanding at any one time is almost \$1.8 billion; not including the current sale, total bonds and obligations outstanding approximates just over \$1 billion, inclusive of debt issued under the 2005 and 2010 bond resolutions.

Senate bill 46 was enacted in the 2015 legislative session and permits the issuance of bonds or notes by the bond bank to state joint action agencies as well as for those of an RHO. This approval followed authorization for borrowing by the University of Alaska in 2014; in all cases, broadening the original scope of the bond bank's role for financing local government capital projects. RHO bond bank obligations are subject to certain limitations and requirements including a maximum outstanding debt limit of \$205 million. In addition to the debt issuance cap, the bond bank may not finance more than 49% of project costs, the remaining costs of the project must be secured prior to the bond authority provides financing, and the bond bank bonds may not exceed \$102.5 million for any single project. The first issuance for an RHO under the 2016 resolution occurred in May 2016 for just over \$44 million.

The current bonds will provide \$102.5 million in funds to the Yukon-Kuskokwim Health Corporation (YKHC) for the construction of a new primary care clinic and a new inpatient unit and the renovation of an existing hospital in Bethel. The balance of funding for the \$308 million project largely derives from a \$165 million U.S. Department of Agriculture (USDA) community facility direct loan and \$21.9 million in equipment financing. YKHC is contributing \$17.6 million to the project from cash on hand. An interim conduit loan for construction of the clinic portion of the project by the Alaska Industrial and Export Authority will be repaid by proceeds of the USDA loan. The bond bank and USDA loans will be parity obligations.

There are 13 RHOs located in the state of Alaska that provide the majority of health care services to Native Alaskans, accounting for over 20% of the residents in the state. Key revenue sources for the RHOs are federal Indian Health Services (IHS), Medicaid, Children's Health Insurance (CHIP), private health insurance, federal department of health and human services (DHHS) and state DHHS grants, and Medicare. IHS provides the majority of revenue to the RHOs at 63% of the total, followed by Medicaid and CHIP at 15%, and is primarily directed to staffing expenses. The federal government's responsibility to provide health care to Native Americans is a trust obligation and IHS is not allowed to reduce funding for programs unless the U.S. Congress reduces appropriations.

STRONG SECURITY PROVISIONS

In addition to security provisions offered by the bond bank itself, the bond bank establishes additional borrower security provisions to ensure full and timely repayment of its loans. For the current issue, the RHO will establish a borrower reserve fund, provide a gross pledge of non-IHS revenues to the bond bank, and maintain a lock box for the receipt of daily pledged revenues that are deposited with the trustee for the bonds on a monthly basis. Additional borrower covenants include the maintenance of debt service coverage ratios, an additional bonds test, and a requirement for days cash on hand.

ALASKA'S RESOURCE-DEPENDENT REVENUE SYSTEM

Alaska's 'AA+' IDR reflects the state's maintenance of very substantial reserve balances and conservative financial management practices to offset significant revenue volatility linked to oil production from the North Slope and global petroleum price trends. For many years, the state focused on expected declines in production at its oil fields, prudently dedicating a substantial share of its past oil tax revenue to reserves to ease anticipated revenue loss due to the declines. However, the steep drop in crude oil prices beginning in late 2014 exceeded expectations and significantly reduced tax revenues to the state, requiring sizable use of reserves to fund operations in fiscal years 2015 through 2017.

For fiscal 2016, the state funded a \$3.4 billion (69% of the Unrestricted General Fund [UGF]) budget gap by drawing on reserves, bringing the reserve balance at year-end to about \$14.7 billion, almost 3x the UGF budget. The enacted UGF budget for fiscal 2017 totals \$4.4 billion, a 12% reduction from fiscal 2016. The enacted budget continues the state's reliance on reserves to fund operations as most revenue raising proposals and a proposed funding shift related to the state's Permanent Fund Earnings Reserve (PFER) were not approved. The legislature did approve changes to the state's tax credit structure for crude oil and natural gas production to provide savings in future fiscal years but at a significant cost to the fiscal 2016 budget.

The enacted fiscal 2017 budget incorporated the governor's veto of one-half of the statutorily-determined permanent fund dividend distribution, reducing the distribution from the PFER by \$665 million. Considering these and other measures, a reserve draw of \$2.9 billion (67% of the UGF

budget) to fund operations is expected. Due to the reduction in expenditures and interest earnings, reserves at the end of fiscal 2017 are expected to total \$14 billion, equal to 3.2x the UGF budget.

The governor's proposed \$4.3 billion fiscal 2018 UGF budget is supported by almost \$1.6 billion in existing revenue sources, \$55 million in new revenue sources, a \$2.5 billion use of funds from the PFER, and an \$892 million draw on reserves. The budget also proposes a \$2.4 billion use of funds from the PFER that would be retroactive to the current fiscal year. These actions incorporate the governor's proposed funding shift related to the PFER that is similar to a proposal that received some legislative traction in the 2016 session. The legislature will consider this proposal in the current legislative session.

For further information on the state, please see 'Fitch Rates Alaska's \$2.3B Pension Obligation Bonds 'AA'; Outlook Negative' dated Oct. 7, 2016, available at 'www.fitchratings.com'.

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Additional information is available at 'www.fitchratings.com'.

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
<https://www.fitchratings.com/site/re/879478>

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