

**01/24/2013
OVERVIEW:
FALL 2012
REVENUE AND
PRICE
FORECAST
DEPARTMENT OF
REVENUE**

<TARGET><BILL></BILL><SUBJECT>01-24-2013 OVERVIEW FALL
2012 REVENUE AND PRICE FORECAST DEPARTMENT OF
REVENUE</SUBJECT><COMM>SFIN28</COMM></TARGET>

ALASKA STATE LEGISLATURE

SENATE FINANCE COMMITTEE

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AGENDA

Thursday, January 24, 2013 Senate Finance Room 532 – 9:00 AM
Department of Revenue: State's Savings Accounts Update
Overview of Fall 2012 Revenue Forecast



Outline



- **Fall 2012 Revenue Forecast**
 - Ten-year overview
 - Comparison to Spring 2012 Forecast
 - Total Revenue
 - Unrestricted Revenue
 - Oil and Non-Oil Revenue
- **Components of Production Tax Forecast**
 - Oil Production
 - Oil Price



Fall 2012 Revenue Forecast



Price, Production, State General Fund Unrestricted Revenues FY 2012 -2022



	Actual	Forecast				
	2012	2013	2014	2015	2016	2017
ANS WC Oil Price (\$/bbl)	\$112.65	\$108.67	\$109.61	\$111.67	\$114.88	\$116.22
Total ANS Production (State + Federal) (ths bbls/day)	579.1	552.8	538.4	518.6	499.7	476.1
General Fund Unrestricted Revenues (million)	\$9,485	\$7,512	\$7,002	\$6,659	\$6,999	\$7,105

		Forecast				
		2018	2019	2020	2021	2022
ANS WC Oil Price (\$/bbl)		\$117.16	\$118.29	\$119.74	\$121.42	\$123.34
Total ANS Production (State + Federal) (ths bbls/day)		442.9	421.6	394.8	365.9	338.5
General Fund Unrestricted Revenues (million)		\$6,970	\$6,719	\$6,487	\$6,209	5,969

Source: Fall 2012 Revenue Sources Book



Comparison

Fall 2012 forecast with Spring 2012 forecast

FY 2013	Spring 2012	Fall 2012	Difference	Change
Oil Price (ANS West Coast per barrel)	\$110.44	\$108.67	(\$1.77)	-1.63%
Avg ANS oil Production (ths barrels/day)	563	553	(10.00)	-1.78%
Unrestricted GF Revenue (million)	\$8,440.10	\$7,511.70	(\$928.40)	-11.00%
FY 2014				
Oil Price (ANS West Coast per barrel)	\$109.12	\$109.61	\$0.49	0.45%
Avg ANS oil Production (ths barrels/day)	567	538	(29.00)	-5.11%
Unrestricted GF Revenue (million)	\$7,680.40	\$7,001.90	(\$678.50)	-8.83%
Two Year Totals				
Two year average price (ANS West Coast per barrel)	\$109.78	\$109.14	(\$0.64)	-0.58%
Two year average production (ths barrels/day)	565	546	(19.50)	-3.45%
Two year unrestricted GF Revenue (million)	\$16,120.50	\$14,513.60	(\$1,606.90)	-9.97%

Sources: Department of Revenue Spring 2012 Revenue Forecast and Fall 2012 Revenue Forecast



Total Revenue Forecast

FY 12, 13 & 14 (millions \$)



Revenue Type	Actual	Forecast	
	FY 2012	FY 2013	FY 2014
Unrestricted General Fund			
Oil Revenue	\$ 8,857.8	\$ 6,904.0	\$ 6,399.0
Non-Oil Revenue*	\$ 519.6	\$ 541.5	\$ 535.5
Investment Revenue	\$ 107.8	\$ 66.2	\$ 67.5
Total Unrestricted Revenue	\$ 9,485.2	\$ 7,511.7	\$ 7,001.9
Designated General Fund			
Non-Oil Revenue*	\$ 268.2	\$ 311.7	\$ 310.0
Investment Revenue	\$ 34.6	\$ 41.4	\$ 33.7
Subtotal	\$ 302.8	\$ 353.1	\$ 343.7
Other Restricted Revenue			
Oil Revenue	\$ 1,021.7	\$ 1,138.0	\$ 858.4
Non-Oil Revenue*	\$ 184.5	\$ 209.9	\$ 210.8
Investment Revenue	\$ 109.7	\$ 3,286.0	\$ 3,369.5
Subtotal	\$ 1,315.9	\$ 4,633.9	\$ 4,438.7
Federal Revenue			
Oil Revenue	\$ 4.8	\$ 2.7	\$ 2.7
Federal Receipts	\$ 2,455.5	\$ 2,822.7	\$ 2,822.7
Subtotal	\$ 2,460.3	\$ 2,825.4	\$ 2,825.4
Total State Revenue	\$ 13,564.2	\$ 15,324.1	\$ 14,609.7

*Except federal and investment

Source: Fall 2012 *Revenue Sources Book*

Alaska Department of Revenue



General Fund Unrestricted Revenue (million \$)



Revenue Type	Actual		Forecast			
	2012	Percent	2013	Percent	2014	Percent
Petroleum Revenue						
Net Royalty (less PF & SF)	\$2,031.7	21.4%	\$1,881.0	25.0%	\$1,914.0	27.3%
Production Tax	\$6,146.1	64.8%	\$4,353.2	58.0%	\$3,778.8	54.0%
Corporate Income Tax	\$568.8	6.0%	\$558.2	7.4%	\$606.9	8.7%
Property Tax	\$111.2	1.2%	\$111.6	1.5%	\$99.3	1.4%
Total Petroleum Revenue	\$8,857.8	93.4%	\$6,904.0	91.9%	\$6,399.0	91.4%
Non-petroleum Revenue	\$627.4	6.6%	\$607.7	8.1%	\$602.9	8.6%
Total Revenue	\$9,485.2	100.0%	\$7,511.7	100.0%	\$7,001.9	100.0%

NOTE: This presentation only includes the portion of revenue that is included in the "Unrestricted General Fund" category.

*Other includes Charges for Services, Fines and Forfeitures, Licenses & Permits, Rents & Royalties, and Miscellaneous.

Source: Fall 2012 Revenue Sources Book



Unrestricted Non-Oil Revenue

(million \$)



Revenue Type	2012		2013		2014	
	Revenue	% Total	Revenue	% Total	Revenue	% Total
Taxes						
Corporate Income	\$98.5	15.7%	\$111.2	18.3%	\$113.7	18.9%
Mining License Tax	\$40.7	6.5%	\$58.3	9.6%	\$64.0	10.6%
Insurance Premium	\$54.8	8.7%	\$57.9	9.5%	\$58.8	9.8%
Tobacco	\$45.6	7.3%	\$45.7	7.5%	\$45.8	7.6%
Motor Fuel	\$40.9	6.5%	\$40.7	6.7%	\$40.6	6.7%
Other Taxes	<u>\$70.0</u>	11.2%	<u>\$65.5</u>	10.8%	<u>\$66.9</u>	11.1%
Subtotal Taxes	\$350.5	55.9%	\$379.3	62.4%	\$389.8	64.6%
Investments	\$107.8	17.2%	\$66.2	10.9%	\$67.5	11.2%
Other *	<u>\$169.1</u>	27.0%	<u>\$162.2</u>	26.7%	<u>\$145.7</u>	24.2%
Total Non-Oil	\$627.4	100.0%	\$607.7	100.0%	\$603.0	100.0%

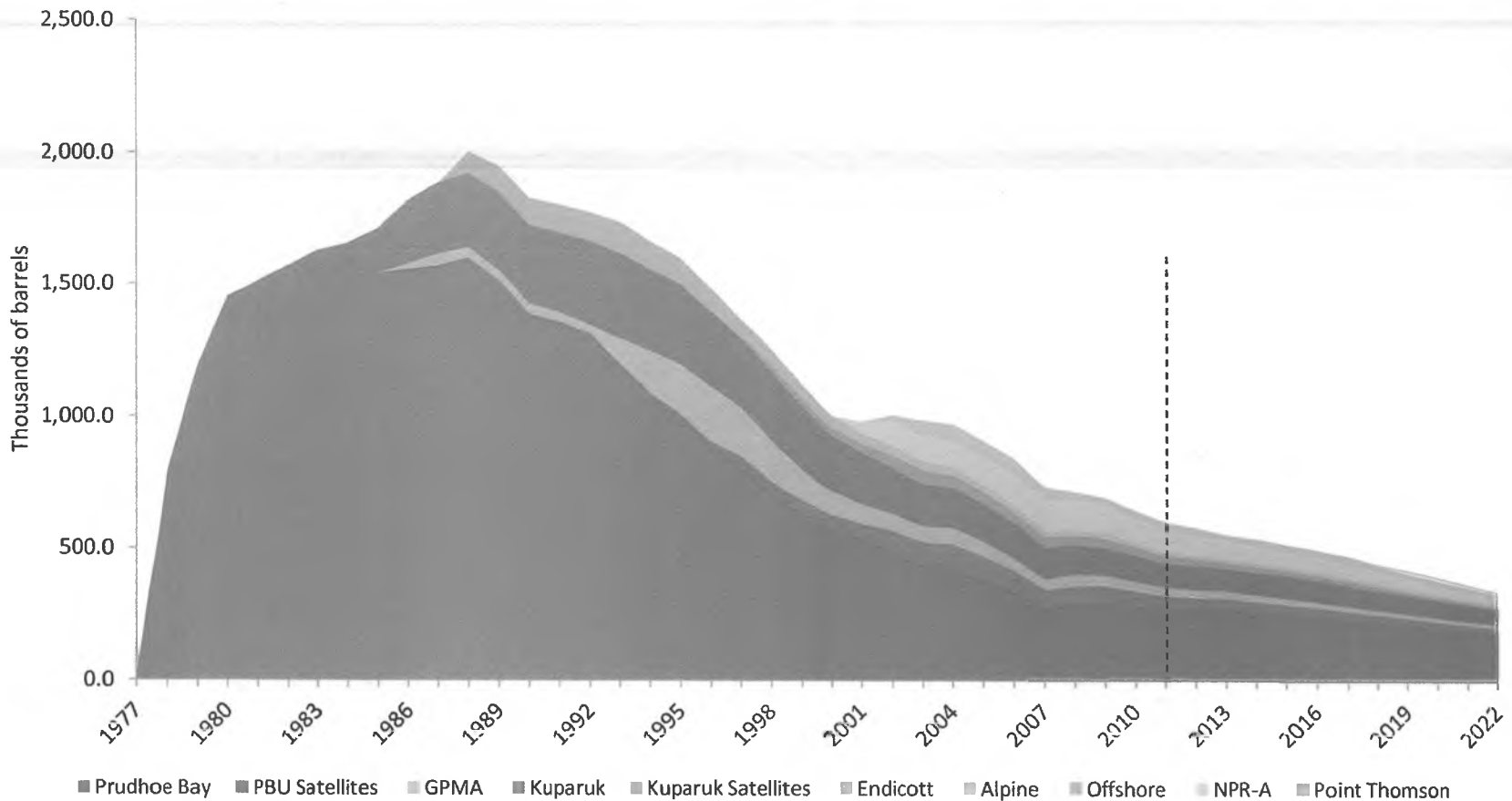
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Source: Fall 2012 Revenue Sources Book



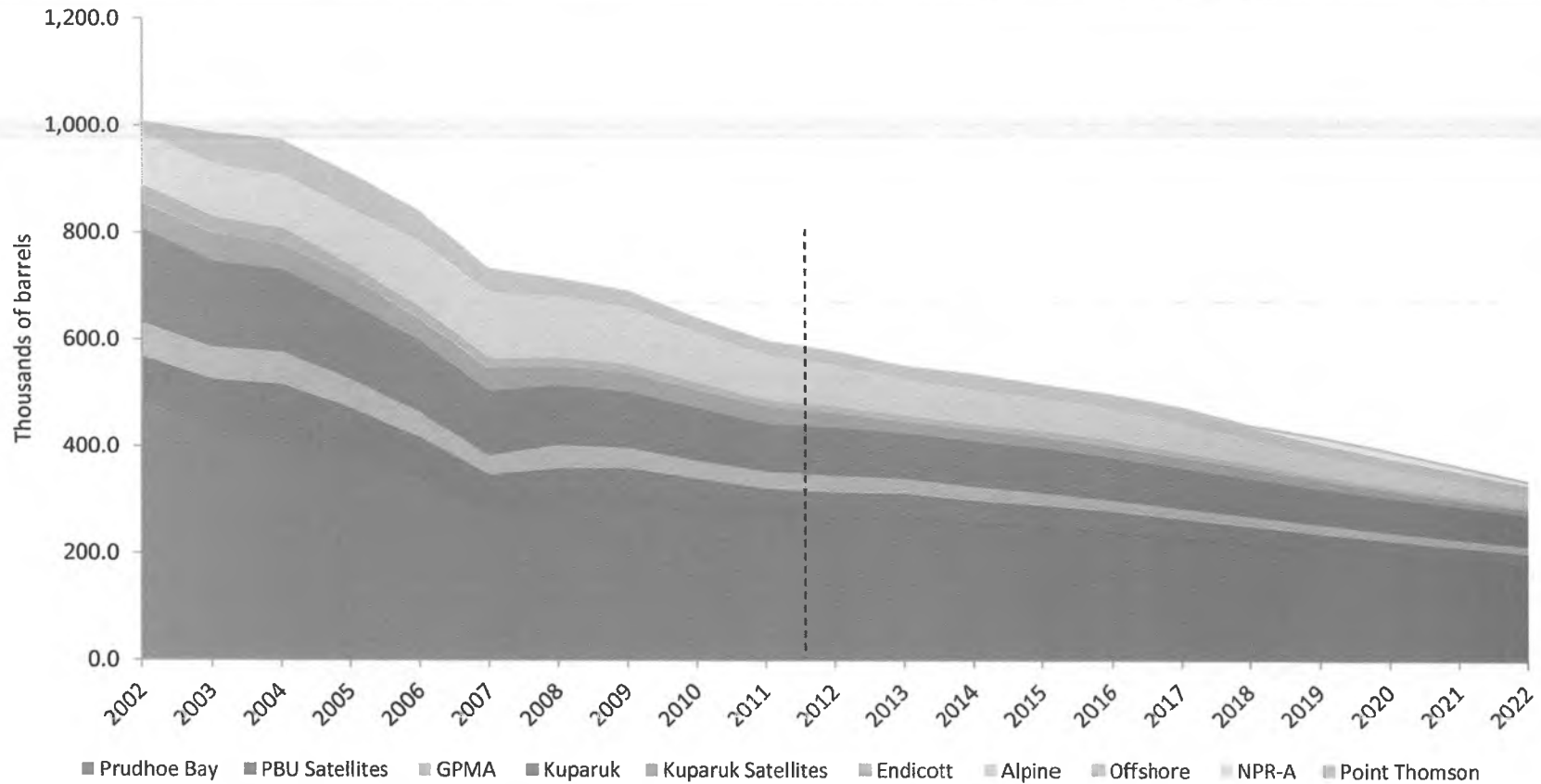
Production History and Forecast



Source: Alaska Department of Revenue Fall 2012 Revenue Sources Book: <http://www.tax.alaska.gov/programs/documentviewer/viewer.aspx?2682f>



Production History and Forecast



Source: Alaska Department of Revenue Fall 2012 Revenue Sources Book: <http://www.tax.alaska.gov/programs/documentviewer/viewer.aspx?2682f>



Fall 2012 Oil Price Forecast



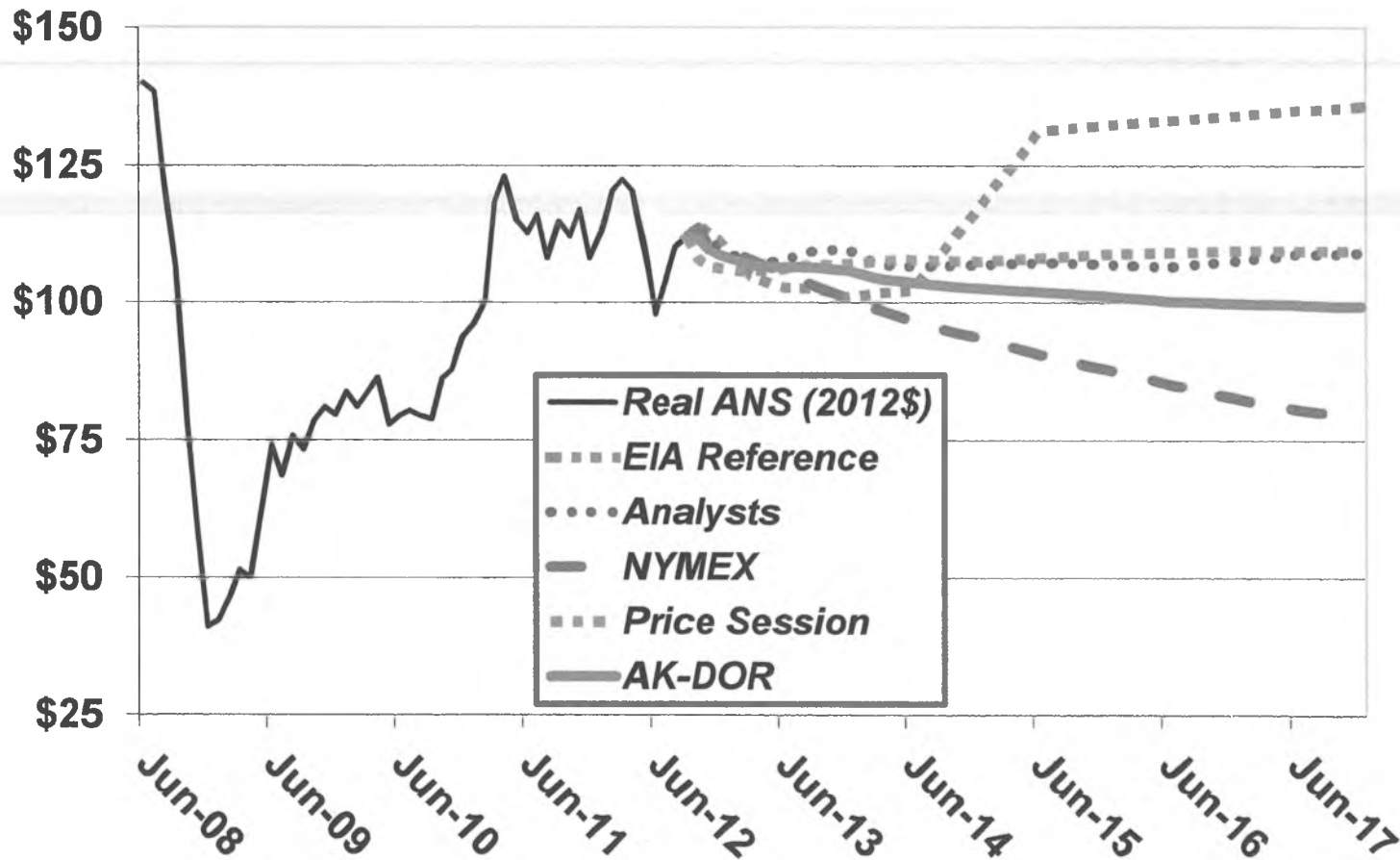
Price Forecast Methodology



- **Four components to price forecast**
 - **DOR oil price forecast session October 2, 2012 with 31 participants from DOR, DNR, DOL, OMB, University, Legislative Finance and outside participants**
 - **Consider supply, demand, geopolitics, financial markets, outside expert forecasts, etc.**
 - **Asked to forecast Alaska North Slope (ANS) crude price directly, not to forecast West Texas Intermediate and adjust, as in previous years, due to widening differential of ANS to WTI.**
 - **Energy Information Agency (EIA) forecast**
 - **New York Mercantile Exchange (NYMEX) – futures market**
 - **Analyst forecast**
- **Forecast is an average of DOR participant forecast from Forecasting Session “blended” (averaged) equally with NYMEX, EIA, and analysts to derive price forecast.**



Price Forecasts as of October 2012



Note: All estimates are for ANS prices, some were converted by Department of Revenue from WTI to ANS.

Sources: DOR, Bloomberg, NYMEX, Energy Information Agency



The End Questions?



Oil Production Forecast



Bruce Tangeman, Department of Revenue

William C. Barron, Division of Oil and Gas

January 24, 2013



Statutory Concerns

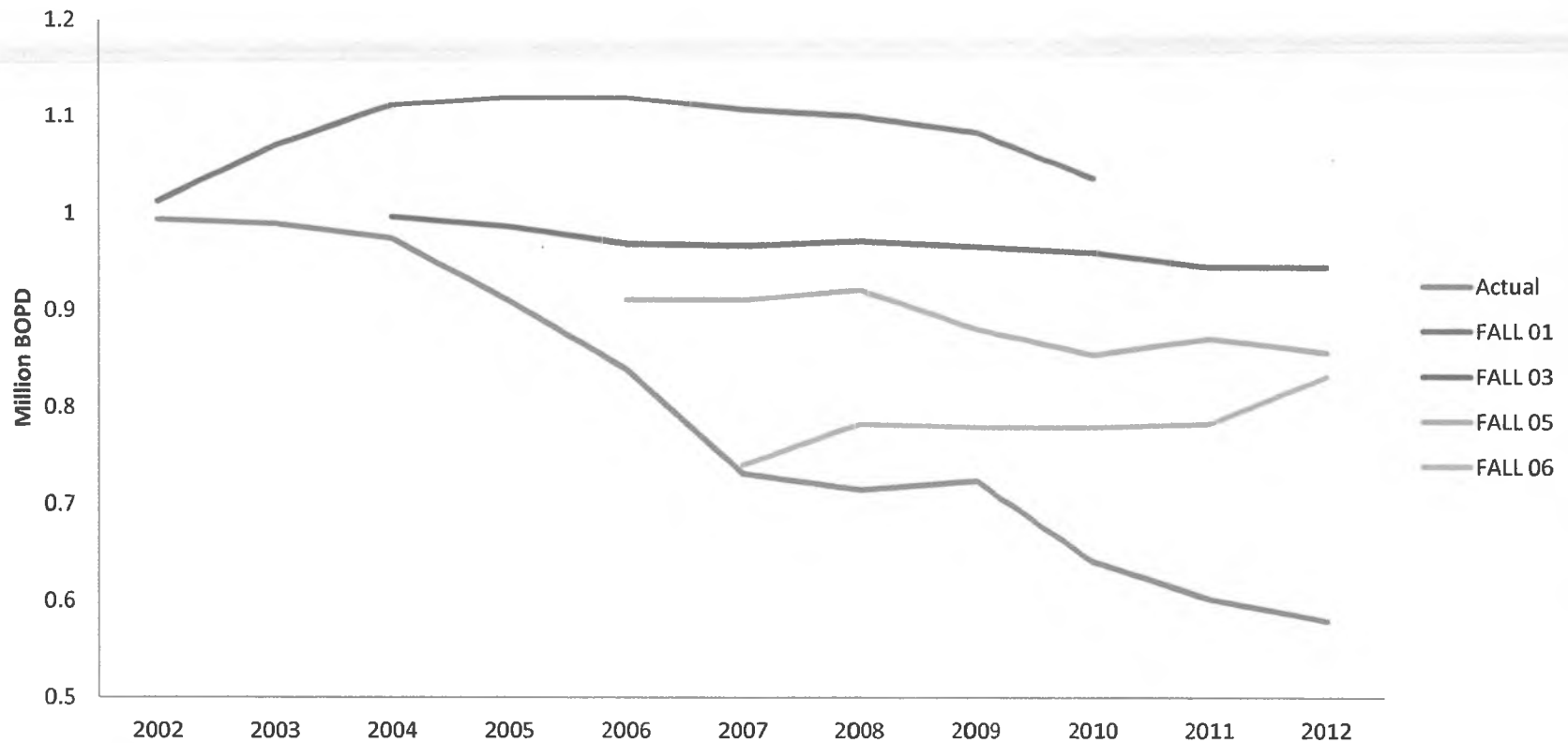
- AS 37.07.020 (b) – *Ten Year Fiscal Plan*.
 - Declares that OMB “must set out *significant assumptions used in the projection with sufficient detail to enable the legislature to rely on the fiscal plan* in understanding, evaluating, and resolving issues of state budgeting,”



Comparing the Production Forecasts Over Time



DOR Forecast Examples



Source: Alaska Department of Revenue Fall Revenue Forecasts ; <http://www.tax.alaska.gov/programs/sourcebook/index.aspx>

1/23/2013



Legislative Direction

Request for improved production forecast that better incorporates variables:

- “Is it possible for the department to come forward with a plan for providing more accountability to the productions forecasts?” ... “I’m looking at a graph, from your department, that shows the forecast, starting in 2001 to 2010, and it seems that the trend is that the department is optimistic in its forecast of the production. I’m wondering if you take into account, relooking at how you are assessing, how you’re figuring out what the forecast will be.”

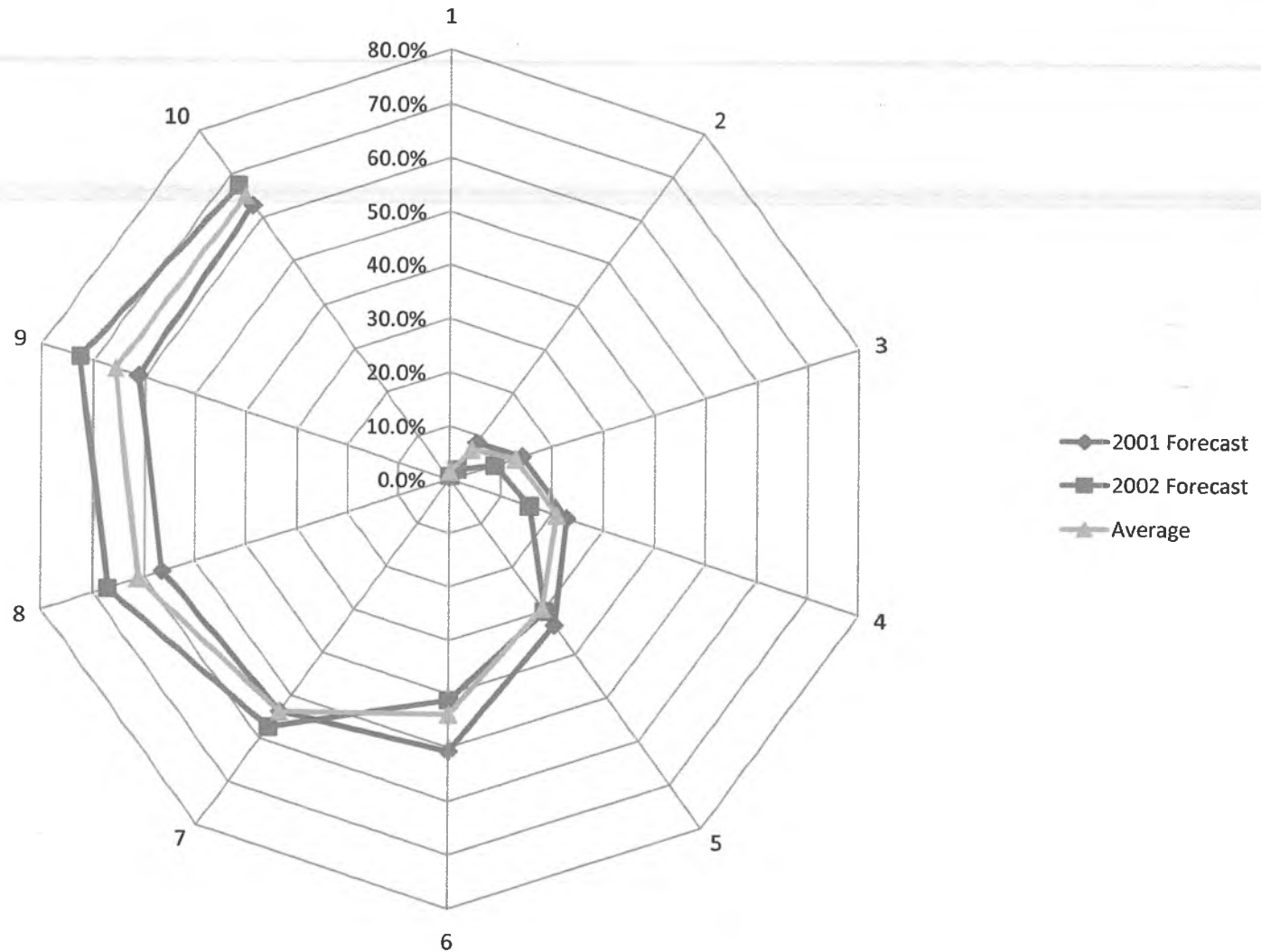
Rep. Costello, House Finance Committee, February 18, 2011

- “What I am asking is that I be given something that will give me more confidence that the projections that we see are, not necessarily 100% accurate, but that they have taken into account everything that they can, and we’ve got the best shot we can get.”

Rep. Doogan, House Finance Committee, February 18, 2011



Forecast Errors by Years in Advance being Forecast



1/23/2013

Source: Alaska Department of Revenue Fall Revenue Forecasts ; <http://www.tax.alaska.gov/programs/sourcebook/index.aspx>



Department of Revenue Response



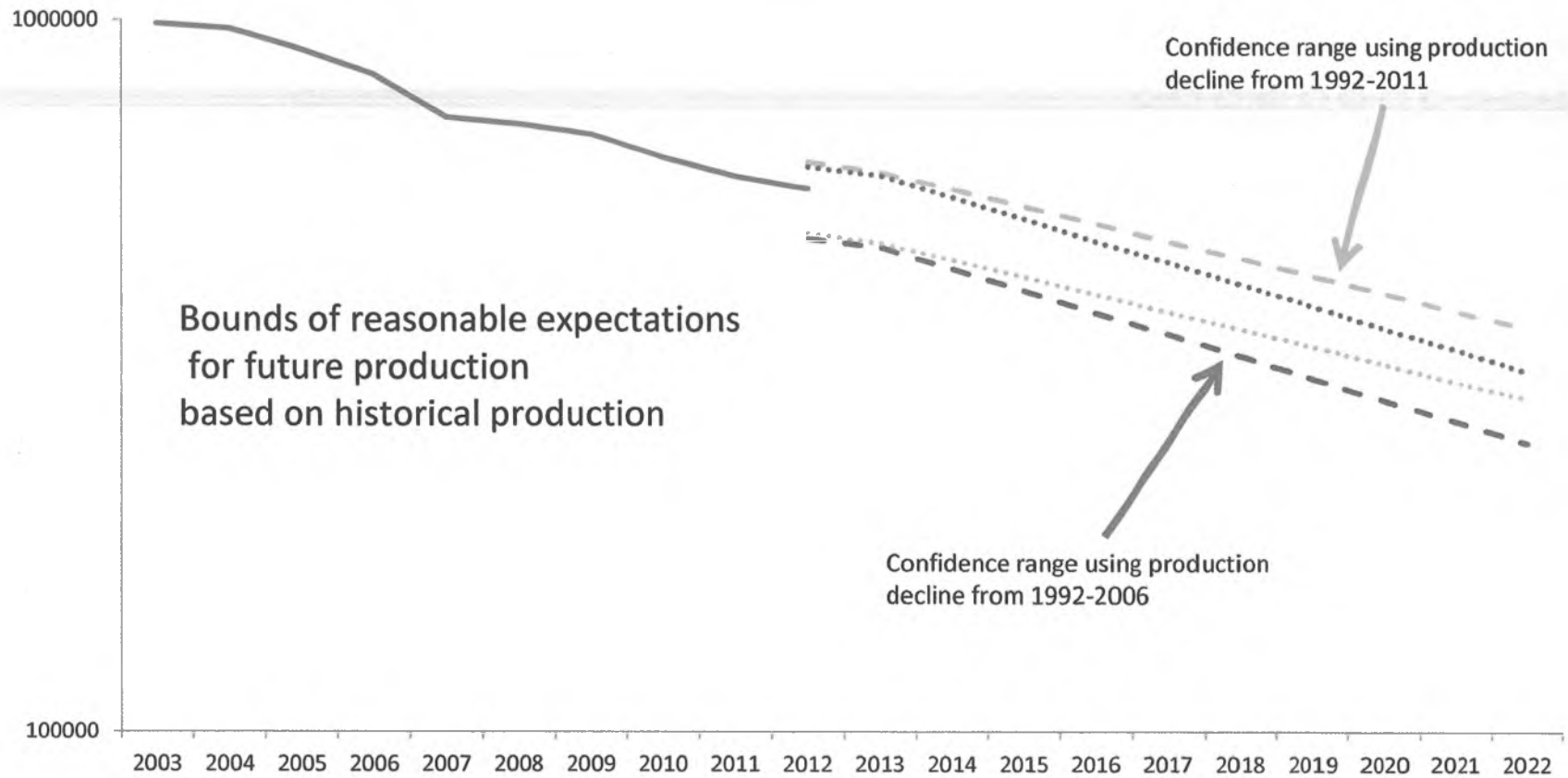
- Addressing consistent over-estimation of production began in 2009.
- In 2012, a DOR team analyzed past forecasts comparing them to actual production.
 - This developed a reasonable range of “confidence bands” for future production.



Historical Production



ANS Production





Components of the Production Forecast

- **Currently Producing (“Old Oil”):**
 - Oil from wells that are in production and following typical reservoir engineering optimization without major investment.
- **Under Development (UD):**
 - Oil from projects that will add incremental oil to existing fields or will bring new fields into production.
 - Project must have senior management approval and be allocated funds in the company’s budget.
- **Under Evaluation (UE):**
 - Oil from projects that are likely to occur in the future, but have not met the requirements of the previous category.
 - Requires that oil reserves are known and recovery is technically possible with current technology.
- ***Under Development + Under Evaluation = “New Oil”***

****These definitions are not equivalent to those used by the Society of Petroleum Engineers (SPE) or Securities & Exchange Commission (SEC) and should not be used as such****



The concept of risk

“Risk is the probability of an event occurring and the potential impact of that occurrence”

Cost Control and Risk Mitigation in Major Projects, Caddy, Fluor Daniel Inc., SPE 1993

“Good E&P business decisions require assessment of both technical and non-technical risk”

Assessing Non-Technical Risks in Oil and Gas Exploration and Production, Barker, Steele, Heaton, SPE, 1998.

“The ability to convey the relative riskiness of various O&G projects in a consistent manner is an elusive and desirable goal.”

Development and Implementation of an Integrated Risk Assessment Methodology. Cutten, Evoy, Grecu. SPE conference paper 1993



Accounting for the Risks Appropriately

- **“Currently Producing”** oil was **not** risked in this forecast
- The **“New Oil”** portion of the forecast was adjusted for these risks starting in FY2015
- The **“Under Evaluation”** portion of the forecast was risked at a greater rate than **“Under Development”**
- **Technical and Non-Technical** risk must be considered



Risk Factor 1: Delays



Historical predictions of new fields coming on line.

"Over 35% of projects are over budget and exceed cycle time by over 10%"

Booze Allen & Hamilton

Years Forward	Number of Predictions	Number Correct	Percent Correct
1 Year	12	12	100%
2 Year	13	10	77%
3 Year	14	4	29%
4 Year	13	3	23%
5 Year	17	4	24%
6 Year	16	0	0%
7 Year	6	1	17%
8 Year	2	0	0%
9 Year	3	0	0%



Risk Factor 2: Performance Deviates from Expectations

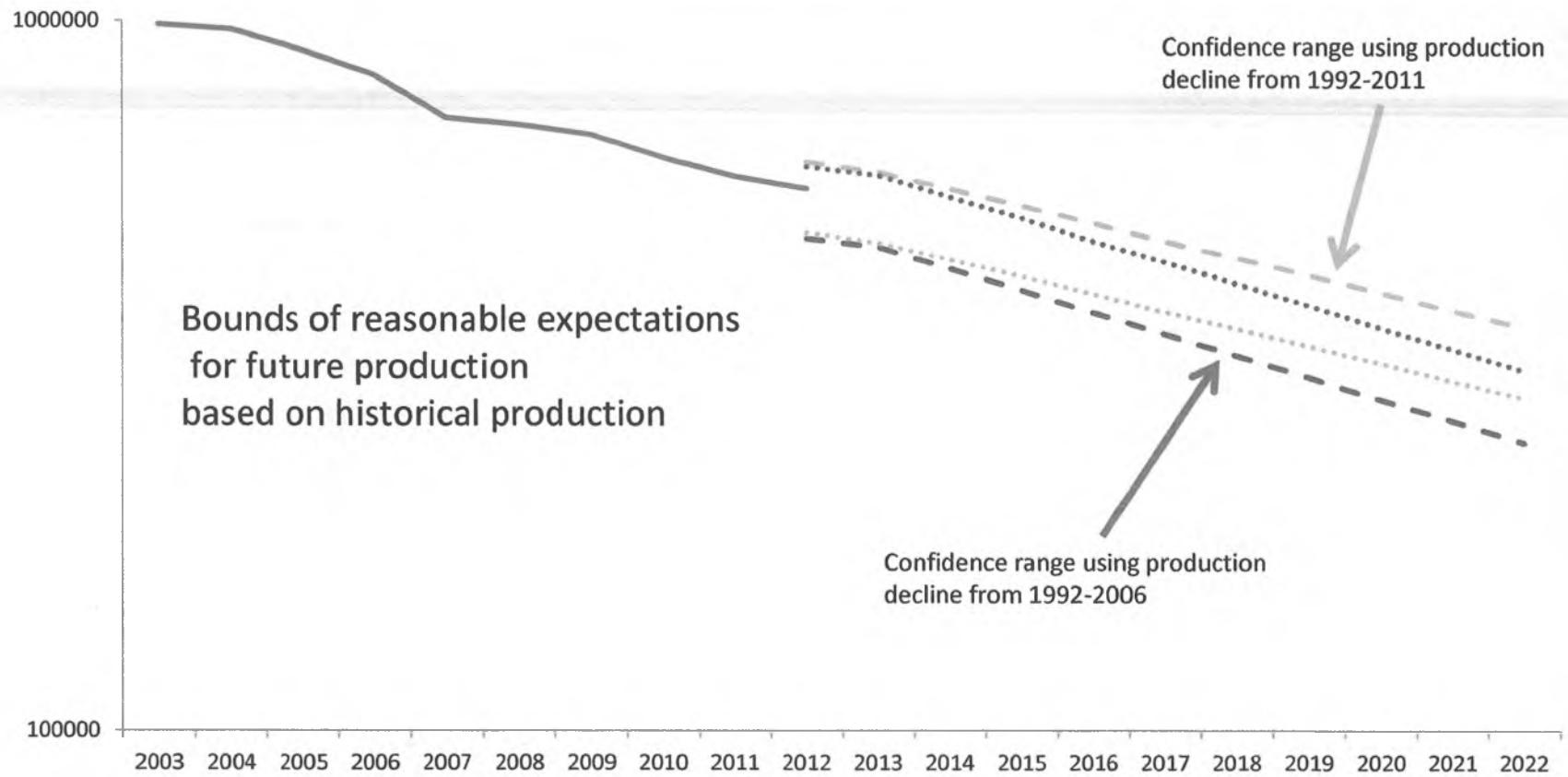
Field	Predicted peak production	Reality	Comment
Badami	~30-35K bpd	Peaked at 18K bpd, rapidly declined to ~1,400 bpd	BP shut down production, Savant currently reviving
Aurora	~15-20K bpd	Peaked at ~10,500 bpd	
Polaris Waterflood	~12-15K bpd	Peaked at ~4,750 bpd	
Prudhoe Bay Satellites	~40K bpd	Peaked at ~50 bpd	



Historical Production

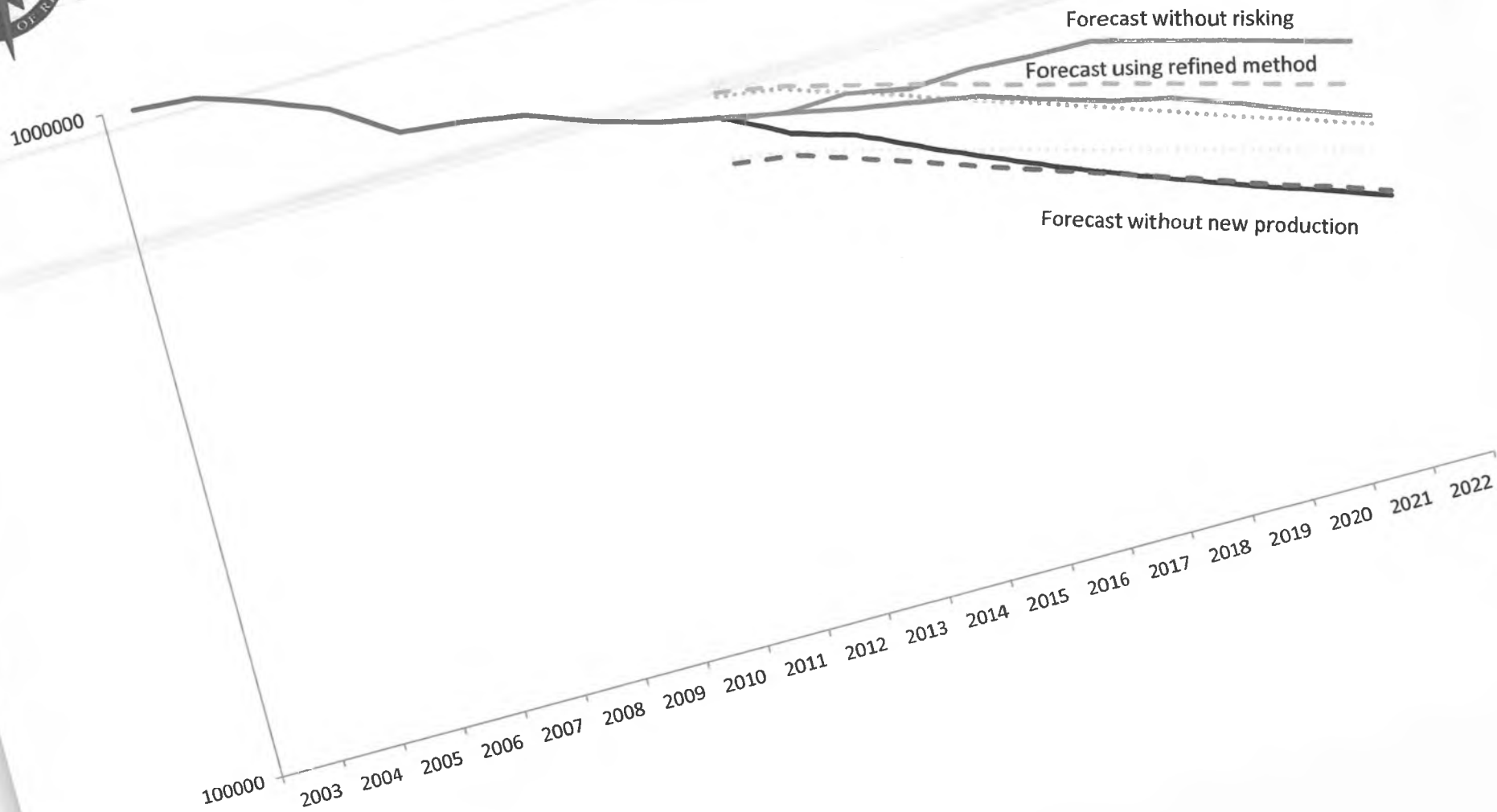


ANS Production





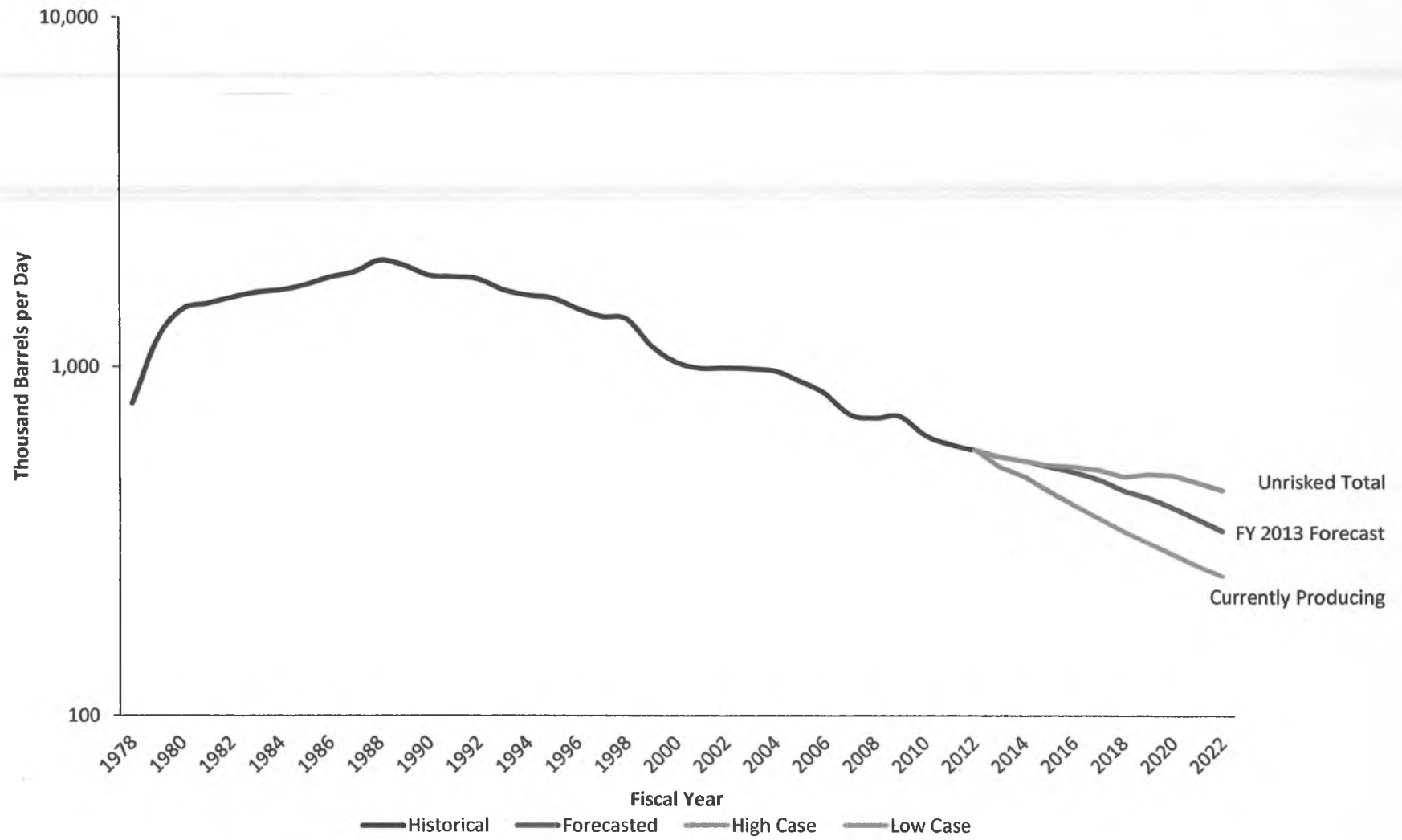
Applying the refined method



1/23/2013

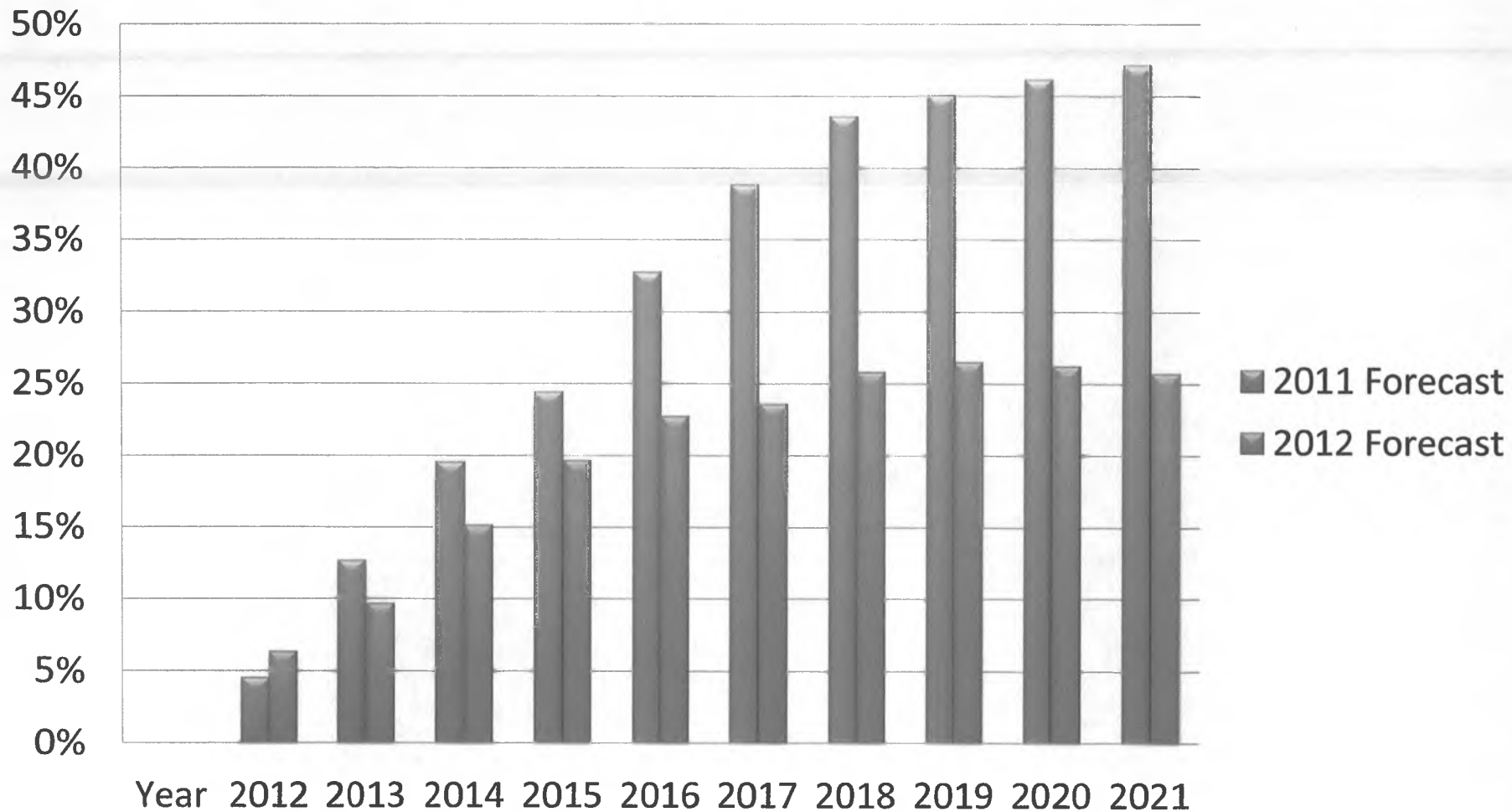


Applying the refined method



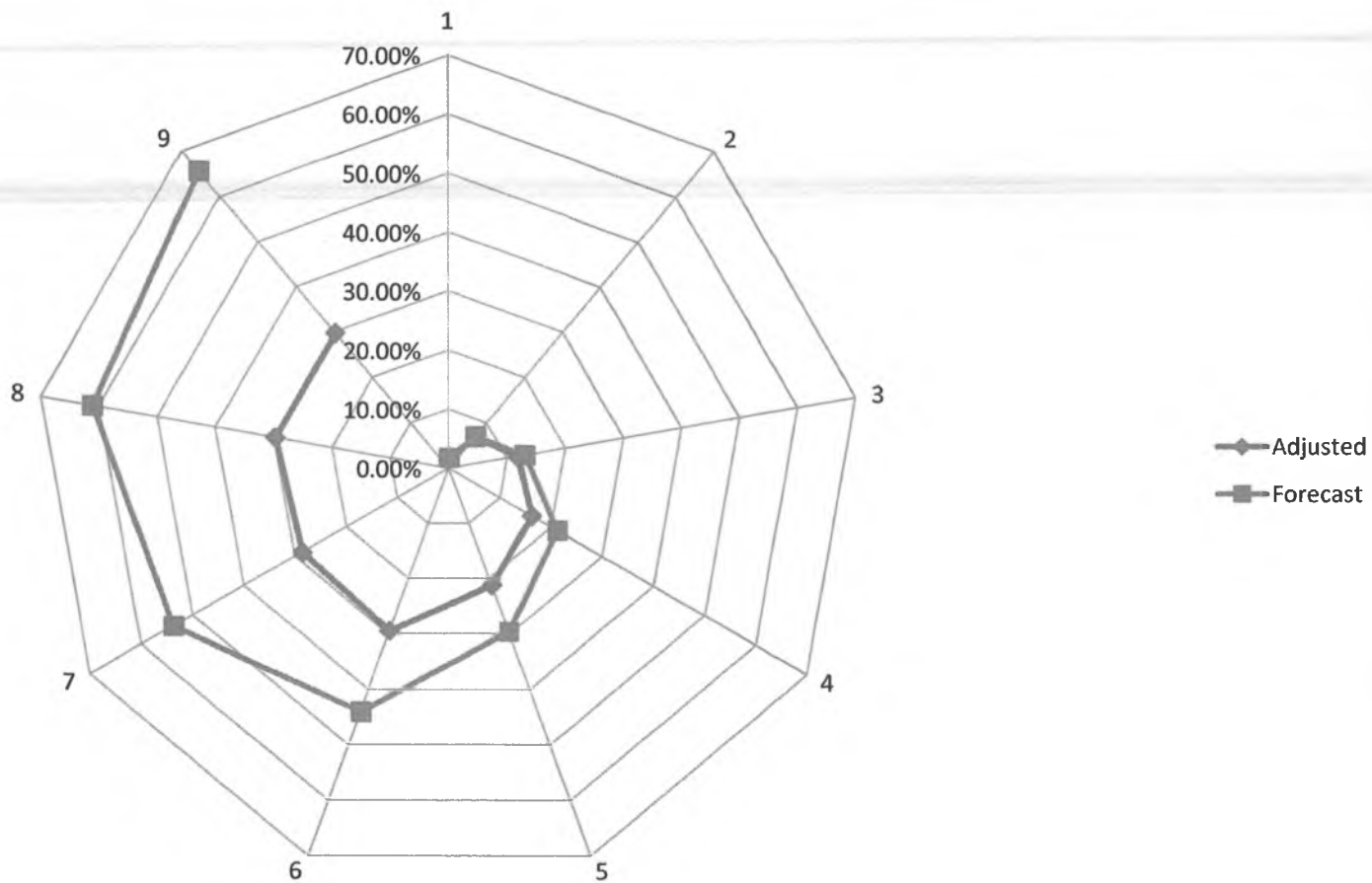


New Oil share of Total Production





Testing the refined method





This will be an ongoing process...



...of assessing the risk associated with Under Development and Under Evaluation.

“The ability to convey the relative riskiness of various O&G projects in a consistent manner is an elusive and desirable goal.”

Development and Implementation of an Integrated Risk Assessment Methodology. Cutten, Evoy, Grecu. SPE conference paper 1993



State of Alaska
An Update on the State's Savings Accounts

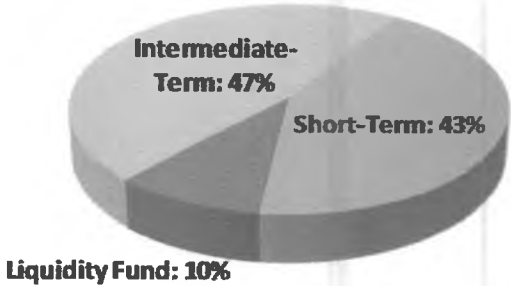
January 24, 2013

Department of Revenue
Treasury Division

1: Comparative Analysis of State Operating and Savings Funds

General Fund and other non segregated investments

Fiduciary oversight: Commissioner of Revenue

		General Fund (and other nonsegregated investments)	
Investment Objective		Moderate Risk, Short to Intermediate investment horizon	
Target Asset Allocation		 <p>A 3D pie chart illustrating the target asset allocation for the General Fund. The chart is divided into three segments: Intermediate-Term (47%), Short-Term (43%), and Liquidity Fund (10%).</p>	
		Actuals	Benchmark*
Market Value (in 000s)	12/31/2010	\$6,589,600	-
	12/31/2011	\$9,207,700	-
	12/31/2012	\$11,670,000	-
Returns (6/30/12)	FY12	1.52%	1.04%
Returns (12/31/12)	YTD	1.00%	0.49%
	FYTD	0.37%	0.26%
	3 Year Actuals	1.79%	1.39%
	5 Year Actuals	2.60%	2.14%
Projected 10 Year Return		2.87%	

*Short-term: 3-month U.S. Treasury Bill; Intermediate-term: Barclays 1-3 Year Gov't Bond Index

Current Fiscal Year market values and stated returns are unaudited, preliminary, and include some estimates

Constitutional Budget Reserve Fund (main & sub)

Fiduciary oversight: Commissioner of Revenue


		Constitutional Budget Reserve (main fund)		Constitutional Budget Reserve (sub fund)	
Investment Objective		Moderate Risk, Intermediate investment horizon		High Risk, Moderately Long investment horizon	
Target Asset Allocation					
		Actuals	Benchmark*	Actuals	Benchmark*
Market Value (in 000s)	12/31/2010	\$5,029,000	-	\$4,928,400	-
	12/31/2011	\$5,290,600	-	\$4,955,400	-
	12/31/2012	\$5,770,800	-	\$5,511,200	-
Returns (6/30/12)	FY12	3.22%	2.80%	0.48%	-0.12%
Returns (12/31/12)	YTD	1.91%	1.42%	11.22%	11.05%
	FYTD	0.78%	0.66%	6.18%	6.09%
	3 Year Actuals	3.29%	2.94%	7.57%	7.29%
	5 Year Actuals	3.95%	3.60%	2.64%	2.58%
Projected 10 Year Return		3.01%		6.31%	

*Short-term: 3-month U.S. Treasury Bill; Intermediate-term: Barclays 1-3 Year Govt. Bond Index; Broad Market: Barclays U.S. Aggregate; Domestic Equity: Russell 3000 Stock Index; International Equity: MSCI EAFE

Current Fiscal Year market values and stated returns are unaudited, preliminary, and include some estimates

Power Cost Equalization Fund

Fiduciary oversight: Commissioner of Revenue



		Power Cost Equalization Fund	
Investment Objective		High Risk, Moderately Long investment horizon	
Target Asset Allocation			
		Actuals	Benchmark*
Market Value (in 000s)	12/31/2010	\$352,600	-
	12/31/2011	\$716,300	-
	12/31/2012	\$787,500	-
Returns (6/30/12)	FY12	1.67%	1.19%
Returns (12/31/12)	YTD	13.70%	12.93%
	FYTD	7.38%	6.80%
	3 Year Actuals	9.00%	8.22%
	5 Year Actuals	3.87%	3.12%
Projected 10 Year Return		7.00%	

*Broad Market: Barclays U.S. Aggregate; Domestic Equity: Russell 3000 Stock Index; International Equity: MSCI EAFE

Current Fiscal Year market values and stated returns are unaudited, preliminary, and include some estimates

Public School Trust Fund (Principal and Income accounts)

Fiduciary oversight: Commissioner of Revenue

		Public School Trust Fund (Principal)		Public School Trust Fund (Income)	
Investment Objective		Moderate Risk, Long Term investment horizon		Low Risk, Short investment horizon	
Target Asset Allocation		<p>International Equity: 15%</p>  <p>Domestic Equity: 27% Broad Market: 58%</p>		 <p>Short-Term Fixed Income: 100%</p>	
		Actuals	Benchmark*	Actuals	Benchmark*
Market Value (m 000s)	12/31/2010	\$407,600	-	\$15,700	-
	12/31/2011	\$433,400	-	\$14,300	-
	12/31/2012	\$487,200	-	\$10,400	-
Returns (6/30/12)	FY12	5.84%	6.29%	0.40%	0.06%
Returns (12/31/12)	YTD	10.71%	10.86%	0.49%	0.11%
	FYTD	4.93%	4.92%	0.19%	0.07%
	3 Year Actuals	9.22%	9.39%	0.46%	0.11%
	5 Year Actuals	5.11%	4.92%	0.89%	0.52%
Projected 10 Year Return		5.59%		2.75%	

*Short-term: 3-month U.S. Treasury Bill; Broad Market: Barclays U.S. Aggregate; Domestic Equity: Russell 3000 Stock Index

Current Fiscal Year market values and stated returns are unaudited, preliminary, and include some estimates

PERS & TRS

Fiduciary oversight: Alaska Retirement Management Board

PERS Retirement Defined Benefit Pension / Health

TRS Retirement Defined Benefit Pension / Health

Investment Objective		Moderate Risk, Long Term investment horizon		Moderate Risk, Long Term investment horizon	
Target Asset Allocation		<ul style="list-style-type: none"> ■ 14% Fixed Income ■ 27% Domestic Equity ■ 23% International / Global Equity ■ 16% Real Assets ■ 14% Alternatives / Infrastructure ■ 6% Cash 		<ul style="list-style-type: none"> ■ 14% Fixed Income ■ 27% Domestic Equity ■ 23% International / Global Equity ■ 16% Real Assets ■ 14% Alternatives / Infrastructure ■ 6% Cash 	
		Actuals	Benchmark*	Actuals	Benchmark*
Market Value (in 000s)	12/31/2010	\$10,901,800	-	\$4,603,700	-
	12/31/2011	\$10,873,100	-	\$4,545,200	-
	12/31/2012	\$12,016,500	-	\$5,018,600	-
Returns (6/30/12)	FY12	0.52%	1.02%	0.59%	1.02%
Returns (12/31/12)	YTD	11.87%	10.03%	11.92%	10.03%
	FYTD	5.63%	4.55%	5.68%	4.55%
	3 Year Actuals	8.06%	8.62%	8.17%	8.62%
	5 Year Actuals	1.53%	2.01%	1.54%	2.01%
Long-Term Actuarial Assumed ROR		8.00%		8.00%	

*The ARMB Benchmark is a diversified weighted composite comprised of the following indexes by weight: 27.0% Russell 3000; 23.0% MSCI ACWI ex-US; 14.4% Barclays Intermediate Treasury; 9.6% NCREIF Total; 6.0% 3-Month U.S. Treasury Bill+5.0%; 3.2% Barclays U.S. TIPS; 2.7% MSCI EAFE; 2.7% S&P 500; 2.7% Russell 2000; 1.8% Citi WGBI Non-U.S.; 1.8% HiYld II; 1.6% NCREIF Farmland; 1.6% NCREIF Timberland; 2.0% 3-month U.S. Treasury Bill

Current Fiscal Year market values and stated returns are unaudited, preliminary, and include some estimates

APFC

Fiduciary oversight: Alaska Permanent Fund Corporation Board

Investment Objective		Long Term Investment Goal is to achieve a real rate of return of 5% per year	
Target Asset Allocation		<ul style="list-style-type: none"> ■ 36% Stocks ■ 20% Bonds ■ 12% Real Estate ■ 12% PE / Absolute Return ■ 4% Infrastructure Investments ■ 2% Cash ■ 2% Public / Private Credit ■ 12% Other 	
		Actuals	Benchmark*
Market Value (in 000s)	12/31/2010	\$38,425,100	-
	12/31/2011	\$38,646,700	-
	12/31/2012	\$43,654,800	-
Returns (6/30/12)	FY12	0.02%	-0.21%
Returns (12/31/12)	YTD	12.58%	13.12%
	FYTD	7.34%	7.37%
	3 Year Actuals	8.15%	7.86%
	5 Year Actuals	2.27%	1.60%
Projected 10 Year Return		7.00%	

*The APFC Benchmark is a diversified weighted composite comprised of 20% Barclays Global Corp. Index+ 80% MSCI All Country Index for Company Exposure; 75% NCREIF + 25% Barclays US TIPS Index for Real Assets; Barclays Global Treasury Index(Hedged) for Fixed Income; and 3 Month T-Bill for Cash.

Current Fiscal Year market values and stated returns are unaudited, preliminary, and include some estimates

2: FY2011 Investment Revenue Forecast

FY2013 Investment Revenue Forecast

All Amounts in \$ Millions

Prepared January 22, 2013 by the State of Alaska - Department of Revenue

FY 2012 Actuals	
	Actual through 06-30-12
UNRESTRICTED	
Investments	104.8
Interest Paid by Others	3.0
TOTAL UNRESTRICTED	107.8
RESTRICTED	
Investments - Designated GF	9.2
Investments - Other Restricted	18.5
<i>CBRF - Main Account</i>	<i>166.7</i>
<i>CBRF - Special Sub Account</i>	<i>24.4</i>
CBRF - Total	191.1
Other Treasury Managed Funds	25.4
Alaska Permanent Fund	(99.9)
TOTAL RESTRICTED	144.3
GRAND TOTAL	252.1

FY 2013 Forecast - Based on actuals through Dec 31, 2012			
	Actual through 12-31-12	Forecast through 06-30-13	Total FY13
UNRESTRICTED			
Investments	33.5	25.1	58.6
Interest Paid by Others	0.5	2.2	2.7
TOTAL UNRESTRICTED	34.0	27.3	61.3
RESTRICTED			
Investments - Designated GF	2.9	2.1	5.0
Investments - Other Restricted	6.0	4.1	10.1
<i>CBRF - Main Account</i>	<i>42.9</i>	<i>26.0</i>	<i>68.9</i>
<i>CBRF - Special Sub Account</i>	<i>320.8</i>	<i>162.3</i>	<i>483.1</i>
CBRF - Total	363.7	188.3	552.0
Other Treasury Managed Funds	22.8	13.1	35.9
Alaska Permanent Fund	2,879.3	N/A*	2,879.3
TOTAL RESTRICTED	3,274.7	207.6	3,482.3
GRAND TOTAL	3,308.7	234.9	3,543.6

Notes:

FY2013 investment forecasts include actual data through Dec 31, 2012 and projections for the remainder of FY2013.

Due to financial market volatility, forecasts shown are subject to review and adjustment.

*Please refer to APFC Fund Financial History & Projections as of Dec. 31, 2012 for mid case and quartile projections.

Current Fiscal Year market values and stated returns are unaudited, preliminary, and include some estimates

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.moody.com for a copy of this methodology.

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Alaska; Appropriations; General Obligation; Moral Obligation

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Alaska; Appropriations; General Obligation; Moral Obligation

Credit Profile

US\$153.215 mil GO bnds ser 2013B due 08/01/2025

Long Term Rating AAA/Stable New

US\$11.945 mil GO bnds (Qscb) ser 2013A due 08/01/2035

Long Term Rating AAA/Stable New

Alaska GO

Unenhanced Rating AAA(SPUR)/Stable Affirmed

Alaska Mun Bnd Bank, Alaska

Alaska

Alaska Mun Bnd Bank GO

Unenhanced Rating AA(SPUR)/Stable Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AAA' rating to Alaska's \$11.9 million series 2013A (taxable qualified school construction) and \$153 million series 2013B general obligation (GO) bonds. We also affirmed our 'AAA' rating on Alaska's previously issued GO bonds, our 'AA+' rating on the state's appropriation-backed certificates of participation, and our 'AA' rating on the state's moral-obligation-backed debt. The outlook on all the ratings is stable.

The ratings reflect our view of the state's:

- Strong financial management and frequently accurate forecasting, which we view as beneficial to credit because of the state's reliance on volatile oil-derived revenue (which fluctuate with the price of oil);
- Financial flexibility enhanced by the maintenance of large reserves derived from windfall oil revenue since fiscal 2008 and the prefunding of a substantial portion of the proceeding years' expenditures with current year revenue; and
- Moderate debt burden, significant pay-as-you-go financing of capital needs, and closed defined-benefit retirement system, despite a relatively large lingering unfunded actuarial accrued liability (UAAL).

The GO bonds are backed by the state's full faith, credit, and resources.

Alaska's economy and finances are highly resource dependent, with more than 90% of general fund revenue being oil-related. To a significant extent, the state's financial management has helped offset the risk of revenue volatility, which is inherent to an oil-based economy, by constructing a fiscal structure layered with reserves and extensive operating flexibility. Among the most prominent of these are:

- An accumulation of multiple budget reserves equal to well over 200% of the general fund budget;
- A high level of pay-as-you-go financing of capital needs, which could be reduced to fund operations if the state deems doing so necessary;

- Extensive forward-funding of significant areas of the state's operating budget, a practice that could be halted in an underperforming revenue environment;
- Twice the constitutionally required contributions to the state permanent fund of revenue from oil and gas rentals, royalties, and leases; and
- Untapped potential sources of tax revenue, such as statewide sales or personal income taxes, neither of which the state levies at present.

State financial performance in fiscal years 2012 and 2013 and the governor's proposed budget for fiscal 2014 exhibit the manner in which the above features benefit the state's financial position. As of June 30, 2012, available state budget reserves totaled \$17.96 billion, or 183% of the state's total general fund spending on a budgetary basis (170% of general fund spending on an audited basis, including spending of federal funds and for capital). Measured against just the state's general fund operating budget, total budget reserves equaled 293% (not including capital or spending of federal dollars from the general fund). For fiscal 2013, the state projects total reserves of \$19.04 billion -- 227% of total general fund spending, or 295% when excluding capital spending.

Considering the importance of oil-related revenue to the state's budget, the state's forecasts of both oil prices and production are crucial to its fiscal condition. The state's department of revenue (DOR) has a good track record forecasting year-ahead prices and production levels. In recent years, the state's forecasts have tended to err slightly on the low side (except for fiscal 2009, when actual Alaska North Slope, or ANS, West Coast oil prices came in at \$68.34, almost 18% below the \$83.04 that the state had forecast the year prior). Similarly, the state's forecast of production levels has been highly accurate for the one-year horizon. For fiscal 2012 the state forecast was less than one percentage point below actual production, and for fiscal 2013 the state estimates that its forecast from the previous fall will prove to have been just 0.43% higher than the actual price.

A bigger issue for the state is measuring the long-term rate of oil production decline. Since peaking in 1988, the average annual rate of decline in production has been around 5.5%. However, the state's long-term forecasts have consistently projected a long-term rate of annual production decline of just 2.5% or less. As a result, the state's long-term forecast has tended to overestimate actual production levels. With its fall 2012 forecast, the DOR has revised the methodology used to develop its longer-term production forecast. The new approach applies risk factors to discount the projected oil production from oil fields that are still under development or in the evaluation stage. Previously, production estimates in the forecast from such fields were not adjusted downward to account for their higher level of uncertainty.

For fiscal 2014, the governor's recently proposed budget rests on projected ANS West Coast spot price per barrel of \$109.61 and 538,000 barrels per day (bpd) in production. At these levels, the state is assuming a small 0.87% price increase and a 2.7% decline in production compared with fiscal 2013. Despite the very strong reserves, the governor's spending proposal for state general fund operations is restrained and would increase by just 0.8% if enacted. Total general fund spending, including for capital projects, would actually decline by 14.2% under the governor's proposal because of his request for less capital spending. For the fiscal year, the governor's budget proposal would include \$10.9 billion in total spending. Of this, general fund outlays would total \$7.36 billion, or \$6.5 billion if capital spending is not included.

State revenue in fiscal 2012 produced a \$2.9 billion budgetary surplus after cash funding of more than \$1.66 billion in

capital projects. Pay-as-you-go capital funding in fiscal 2013 increased to \$1.92 billion, and the state still had essentially break-even fiscal results.

Beyond its budget reserves, the state has regularly prefunded some of its major expense items, including education and municipal revenue sharing. For example, in fiscal 2013 the state's prefunding activity totaled \$1.4 billion. Of this, the state is prefunding education spending for fiscal 2014 of \$1.1 billion in fiscal 2013. The governor's budget proposal for fiscal 2014 includes \$1.2 billion in education funding for fiscal 2015. If, in any given year, the state anticipates weaker revenue, it could discontinue the prefunding practice and immediately recognize a like amount of increased one-time budget capacity. Since 2005, the state has prefunded almost \$7 billion of operating expenses.

In the event of a revenue decline, the state could reduce the amount it appropriates for capital funding or the amount of operating budget expenses it prefunds before tapping its reserves. Finally, significant revenue potential resides in a possible statewide sales or personal income tax, which the state does not currently levy.

The unrestricted general fund balance includes the constitutional budget reserve fund (CBRF), which holds the proceeds of disputed oil tax settlement revenue and is available for general fund purposes but requires a three-quarters vote of the legislature for appropriation. However, the state has borrowed against it for general fund expenditures. This fund held \$10.9 billion as of Oct. 31, 2012. In addition, the state constitution requires 25% of all mineral lease rentals and royalties to be deposited into a state permanent fund, with an additional 25% deposit required under state statute. Permanent fund principal can only be invested, but accumulated retained earnings from the fund are available for appropriation by a simple majority vote of the legislature. At the end of October 2012, the total permanent fund had a balance of \$42.37 billion, up 5% since June 30, 2012. The October balance included \$39.4 billion in the restricted principal and \$2.98 billion in the unrestricted permanent fund earnings reserve. The state distributes 50% of the five-year average earnings of the permanent fund each year to residents, but deposits 50% of the fund's earnings into the unrestricted permanent fund earnings reserve (PFER).

Total state net tax-supported GO and general-fund-supported lease debt is moderate, in our view, at \$1,203 per capita (not including municipal school debt and local government capital projects that the state has reimbursed or self-supporting GO bonds that the state has issued through its housing corporation and that are backed by veterans' housing loans). Fiscal 2012 tax-supported GO and appropriation debt service was moderate at 1.2% of general fund and non-major special governmental fund expenditures, not including discretionary state reimbursement for local school debt.

The state has taken steps to reform its pension and retirement systems, which will limit the accumulation of new liabilities. The state closed its defined-benefit retirement plans to new employees in 2006 in favor of a defined-contribution retirement plan. Nevertheless, the remaining unfunded pension liability in the state's multi-employer Public Employees' Retirement System (PERS), Teachers' Retirement System (TRS), and three smaller plans is large and, on a combined basis, equals \$7.07 billion, or \$9,788 per capita. However, the liabilities include the participation of local governments and school districts. The pension funding level as of the most recent actuarial valuation, June 30, 2011, was low, in our opinion, at 61.9% for PERS and 54.0% for TRS. Alaska is amortizing the unfunded pension liability over a 25-year period. The state funds its other post-employment benefits (OPEB) obligations within the retirement systems through a retirement health care trust fund. The separate PERS and TRS

unfunded OPEB liabilities total \$4.04 billion and \$2.04 billion, respectively. These amounts are, on a combined basis, down \$120 million from 2010, when they were \$4.6 billion and \$1.6 billion, respectively. The more significant decline was in 2010, when the combined unfunded liabilities were \$11.8 billion. The reduced actuarial liabilities reflect the application of a new higher assumed rate of return, of 7.2% instead of the prior 4.7%, on invested OPEB assets. As with pensions, the reported OPEB liabilities include the liabilities of the participating local governments and school districts, enlarging their value relative to those of most other states.

Based on the analytic factors we evaluate for states, on a four-point scale on which '1' is the strongest, Standard & Poor's has assigned a composite score of '1.7' to Alaska.

Outlook

The stable outlook reflects our anticipation that the state will manage its windfall from historically high oil prices, which have produced unprecedented budget surpluses, with a long-term focus, but that its unfunded pension and other postemployment liabilities will remain high for the foreseeable future despite the closure of its defined-benefit plans to new entrants. The state has built up substantial reserves to provide essential services in the event of a revenue downturn, while hedging against declines in North Slope oil production and fluctuations in oil prices. Outside of its oil economy, the federal government is an important economic actor, both through military and civilian employment as well as support for specific projects and various state programs. And yet, although the ongoing negotiations surrounding federal fiscal consolidation represent a material risk to the state economy, we believe the state's fiscal position is strong enough to cushion potential direct fiscal or indirect economic effects from reduced federal funding flowing into the state. As such, we continue to view the state's credit outlook as stable despite the threat posed by a reduced federal presence in the state.

Economy

Alaska's economy is largely dependent on the oil extraction and mining industry, but the fishing, timber, and tourism industries are also present. Current high energy prices indicate that economic growth could continue faster than the national average. However, Alaska's high cost of living and dispersed population could restrain growth in non-oil-and-gas-related industries. IHS Global Insight Inc. estimates that construction and mining together account for about 10% of state employment. Employment sectors differ from those of the nation as a whole in some key respects. Alaska's manufacturing employment is 4.0% of total employment compared with 8.1% for the nation, its business and professional services are 8.3% compared with the nation's 11.7%, and its governmental employment 25.8% compared with 15.7% for the nation. This introduces potential exposure to employment losses from federal fiscal consolidation efforts.

Although the state's population has been increasing faster than that of the U.S. as a whole, this fluctuates from year to year. Alaska's population increased 13.3% in 2000 to 2010 compared with 9.7% for the U.S. The state's age dependency ratio -- the ratio of dependent population to total population -- is 51.8% compared with the nation's rate of 58.9%.

Because of its sizable rural population, Alaska's unemployment rate has historically been higher than that of the nation, but in recent years, as national unemployment has increased and the state's unemployment rate has held steady, its seasonally adjusted unemployment rate has fallen below national rates. Alaska's unemployment rate in 2011 was 7.6% compared with 8.9% for the nation. The most recent monthly unemployment rate, for November 2012, was 6.8% compared with the national rate of 7.7%.

As the state's economy has gradually matured, the composition of its employment base has shifted. In recent years, new jobs in health care, construction, and government have offset job losses in timber and seafood processing. In addition to oil, gold and metal ore mining and the possible construction of a major natural gas line could also prove promising for new jobs.

We believe high value mineral production has helped boost Alaska's real gross state product per capita to 147% of per capita U.S. GDP in 2011. State GDP growth has also been strong in recent years, increasing by 2.47% a year on average since 2000 compared with 1.42% for the nation. The federal Bureau of Economic Analysis' 2011 estimate of Alaska's per capita personal income is \$45,665, or 109.9% of the nation's.

Relative to other states, Alaska's income figures are more prone to volatility because of the economic linkages to oil prices, which tend to fluctuate in response to global economic and geopolitical forces. Alaska suffered a severe recession in the mid-1980s following a collapse in oil prices, but since 2004 higher oil prices have contributed to economic growth we consider strong.

Oil production on the North Slope of Alaska occurs primarily at the principal oil fields of Prudhoe Bay and Kuparuk River. Production on the North Slope peaked in 1988 at 2.01 million bpd. Since 1989, production from the North Slope has fallen, offset by a more-than-tripling price of oil. Oil production on the North Slope averaged approximately 579,000 bpd in fiscal 2012. The state's fall 2012 forecast projects average production to continue to gradually decline to 458,000 bpd by 2021.

Alaska continues to exploit its potential for natural resources production aggressively, in our view. The state is exploring the possibility of developing a natural gas pipeline to derive economic benefit from an estimated 36.2 trillion cubic feet of natural gas reserves. The state awarded a license to TransCanada PipeLines Ltd. (A-/Stable) for development of such a pipeline. Through the Alaska Gasline Inducement Act, the state agreed to provide as much as \$500 million in matching funds for the development costs of the project. Shifting market dynamics have led to changes in estimates about the timing and nature of the final project. Separately, in 2010, the legislature created the Alaska Gasline Development Corp. to ultimately deliver natural gas from the North Slope to south central Alaska. The goal of the project is to make deliveries to south central Alaska by 2016.

On a four-point scale, on which '1' is the strongest, Standard & Poor's has assigned a score of '1.4' to Alaska's economic structure.

Governmental Framework

The Alaska constitution requires the governor to submit a balanced budget proposal to the state legislature by Dec. 15

for each fiscal year, which begins on July 1. The governor is required to submit three budgets -- an annual operating budget, a mental health budget, and a six-year capital budget. The governor can line-item veto legislatively approved budget bills. An enacted state budget is not required to stay in balance during the course of the fiscal year after budget adoption, but the governor can hold back expenditures when revenue is below budget.

The state does not have an individual income tax or sales tax, but has occasionally adjusted its formula for oil production and other mining-related tax rates. The state legislature can impose new taxes by majority vote, but a qualifying referendum petition could be filed to challenge new tax legislation. Alaska has the legal authority to re-impose an income tax (which it had in place before 1978) or to impose a sales tax if it so chooses.

Alaska's constitution provides that proceeds of state taxes or licenses "shall not be dedicated to any special purpose" except for restricted federal revenue, money dedicated before statehood, and money required to be placed in the state's permanent fund. As a result, most revenue is placed in Alaska's general fund although the state has created numerous subaccounts within the general fund.

The state's permanent fund was established as a constitutional amendment in 1977, which requires that at least 25% of all mineral lease rentals, royalties, royalty sale proceeds, and federal mineral sharing revenue and bonuses be placed in the fund. An additional 25% is currently deposited to the fund per state statute. Its principal is restricted, but income from the fund is available for use by the general fund.

Alaska has wide legal latitude to cut disbursements as it chooses. It has an appropriation limit and reserves one-third of the amount within the limit for capital projects and loan appropriations. Because state appropriations have never significantly approached the limit, Alaska does not believe the reservation has constrained state operations. The appropriation limit does not apply to the permanent fund.

Voter initiatives may be placed on the ballot upon collection of enough petition signatures to equal 10% of the votes cast at the latest general election. However, successful voter initiatives have the effect of only statutory law and can be overridden or repealed by the legislature after two years. Voter initiatives may not amend the state constitution. In Standard & Poor's opinion, voter initiative activity has not historically affected or hindered state operations.

The state issues GO debt, lease-secured debt secured by annual appropriations, moral obligation debt, and dedicated tax revenue bonds. GO bond authorization requires a simple majority voter approval. GO bonds may be issued only for capital purposes, except for veterans' mortgage guaranteed bonds. The state has issued moral obligation debt for its Bond Bank, for the Alaska Energy Authority, and for the Alaska Student Loan Corp. The state can also legally issue cash flow notes, but has not done so in the past 35 years because of its historically strong cash position.

The Alaska constitution does not specify a priority of payment for GO debt service compared with other expenditures, but annual GO debt service, as a constitutionally authorized debt, could be paid in absence of a specific annual budget appropriation. Generally, the state has appropriated both GO and lease-secured debt service under a separate line-item appropriation.

The state provides assistance to school districts, including discretionary payments since 1970 to subsidize pre-qualified local school district debt service, but also can cut funding if it deems doing so necessary, as long as cuts are distributed

so as to preserve equitable per-pupil funding across the state. The state has provided 60% to 100% reimbursement, depending on different factors.

On a four-point scale on which '1' is the strongest, Standard & Poor's has assigned a '1.5' to the state's governmental framework.

Financial Management

Financial management assessment: 'Good'

We consider Alaska's formal management practices "good" under our financial management assessment (FMA) methodology. An FMA of "good" indicates our view that the state maintains many best practices deemed as critical to supporting credit quality, particularly within the finance department. These practices, however, may not be institutionalized or formalized in policy, may lack detail or long-term elements, or may have little recognition by decision makers outside of the finance department.

The state has a statutory budget reserve within its general fund that, although not always funded, is available to provide liquidity. In addition, the state has also established the constitutional budget reserve fund (CBRF), which voters approved. Funds may be appropriated for certain purposes by a vote of three-fourths of each house of the legislature, but money can be used for interfund borrowing for general fund expenditures. All appropriations from the fund are recorded as a general fund liability.

Budget assumptions are conservative, in Standard & Poor's opinion. The leading predictor of state revenue, the price per barrel of oil, is generally forecast at lower levels than in the current fiscal year. A level of production is forecast as part of this, and budget amendments can occur throughout the year.

Alaska produces detailed revenue forecasts, with the focus being the price of oil, the leading determinant of general fund revenue. Other revenue sources are also included in the revenue source book, which is released twice each year. The tax division of the Alaska Department of Revenue prepares the book, using numerous outside sources of information to help predict the price of oil. Alaska projects expenditures to rise at the rate of inflation.

The state's debt management policy is updated annually with the public debt report. The debt report describes the different types of debt that Alaska issues, mainly certificates of participation and GO bonds. For general-fund-supported bonds, the state has a debt capacity that it determines, by policy, to be 8% of unrestricted revenue.

Investment management is also covered by the investment policy statement, and the performance of the state's investment portfolio is monitored daily. Each year the fund undergoes a fiduciary audit, which includes a review of legal and administrative constraints for each invested fund. The audit policy's stated goal is to keep Alaska's investment process intact during periods of market upheaval.

Alaska enacts an annual capital budget. Expenditure assumptions for the state's operating budget are adjusted as appropriate when capital projects begin. A transportation agency capital plan provides an annually prioritized plan detailing three years of projects and funding sources.

Budget Management Framework

The Alaska Department of Revenue issues formal revenue forecasts twice a year, in the spring and fall. The forecast is based on consultation with an engineering firm and the state department of natural resources. As noted above, the methodology for forecasting oil production has been revised to incorporate the greater variability associated with production forecasts from some oil fields that are still under development or are in the evaluation phase of development. The net effect of these changes has been to increase the long-term rate of production decline. The revenue forecast has historically been used as presented for budget adoption and not adjusted during the budget adoption process.

The state has a recent history of advance funding part of a following year's expenditures for both operating and capital expenditures because of, in our view, the high level of mineral-related revenue Alaska has received. However, in the past, the state has used existing high fund balances to carry deficits, and is not legally required to make midyear budget adjustments in the event a midyear gap develops. The governor has the discretion to hold back spending in the middle of the fiscal year if a budget gap appears to be developing. Such adjustments were last made in fiscal 2009, during oil price fluctuations. The governor can unilaterally prioritize such holdbacks, but the holdbacks have no formal requirement or schedule.

On a four-point scale on which '1' is the strongest, Standard & Poor's has assigned a '2.0' to Alaska's financial management.

Budgetary Performance

The state has no legal requirement to fund reserves at any specified level. However, historically it has held what we believe to be very high total general fund balances, and for the past five years these balances were higher than annual expenditures. With its exceptionally strong cash liquidity, the state's intrayear cash flows are positive, averting the need for it to borrow for cash flow purposes. On an audited basis, the general fund held a \$20.79 billion cash and investment position at fiscal year-end 2012, equal to 222% of general fund expenditures. Although the state has no legal minimum budget reserve requirement, it has created a CBRF that holds money received by the state as a result of legal settlement, administrative proceedings, or litigation of mineral-related revenue. For liquidity purposes, in the past the state has used the CBRF for temporary borrowing within the year or to balance the budget at the end of the year. The CBRF is also available for general expenditures with a three-fourths vote of the legislature and approval of the governor. The most recent borrowing from the CBRF was in fiscal 2005, and the cumulative loan balance from the CBRF was repaid in fiscal 2009; at fiscal year-end 2012, the CBRF held \$10.6 billion.

In addition, the state's statutory budget reserve fund held \$5.2 billion, but the budget reserve has not always been funded in the past. To the extent that the statutory budget reserve has an available balance, Alaska plans to use this reserve first for liquidity purposes before borrowing from the CBRF.

Alaska has no legal requirement to fund services at a specified level, but we believe that its annual distribution to residents of a permanent fund "dividend" might be politically difficult to cut even though it is under no legal

requirement to make this annual payment. Although state per capita income is above the national level, rural areas have pockets of poverty. Nevertheless, we believe state expenditures are relatively predictable, and many in recent years have been funded from prior-year appropriations. In general, Alaska has had a policy of prudently maintaining high fund balances, in light of volatile oil-derived revenue, significant one-time capital and other spending, and the use of surplus revenue to prefund future years' operating expenditures.

The fiscal year ended June 30, 2012 had a significant generally accepted accounting principles general fund operating surplus of \$3 billion, or 33% of expenditures. This left what we consider to be a very high fiscal year-end committed and unassigned general fund balance of \$21.3 billion, or 228% of expenditures. The state has had either an unreserved or unrestricted general fund balance higher than annual expenditures since fiscal 2008, when it produced a record \$7 billion financial windfall from high oil prices and a new tax structure that effectively increased tax rates.

On a four-point scale on which '1' is the strongest, Standard & Poor's has assigned a '1.3' to Alaska's budgetary performance.

Debt And Liability Profile

We calculate Alaska's tax-supported debt per capita as moderate at \$1,203. The state has about \$755.9 million of GO debt, but about \$180.1 million of this is considered self-supporting veteran's-mortgage-revenue-secured debt, leaving about \$575.8 million net tax-supported GO debt. At the end of fiscal 2012, Alaska also had about \$292.6 million of annual appropriation-supported debt. Tax-supported debt (GO and appropriation) to personal income is 2.6%, and tax-supported debt to gross state product is somewhat lower at 1.7%. We believe this is because of the level of mining and resource extraction activity. Tax-supported debt service as a percentage of general government spending was about 1.2% in fiscal 2012, but increases to 2.3% when including the local municipal-school- and capital-reimbursement-related debt paid by the state on behalf of local jurisdictions. About 51% of combined GO and lease debt matures in the next 10 years. Following the planned issuance, Alaska anticipates having capacity for \$453 million of unissued GO debt that voters authorized in November 2012 for transportation-related projects. The governor's fiscal 2014 budget proposal includes approximately \$1.8 billion (all funds) in capital funding.

In 2006, Alaska moved all new employees to a defined-contribution retirement plan from a defined-benefit plan, but employees hired before that continue under the state's defined-benefit pension plan. The Alaska PERS multi-employer plan had a 62% pension-funded ratio at fiscal year-end 2011, the most recent fiscal year for which actuarial data are available, and an unfunded pension liability of \$4.16 billion, which includes the unfunded obligations of other participating local governments. Beginning with the fiscal 2011 valuation, PERS revised down to 8.00% from 8.25% its assumed actuarial investment rate of return.

The separate TRS had a \$2.85 billion unfunded pension liability and 54% funding ratio at its June 30, 2011 actuarial valuation date. We include the TRS liability in this total for across-state comparison purposes although Alaska does not have a direct obligation to fund TRS.

Combined with much smaller unfunded liabilities for public elected officials, judicial officials, and retired national guard and naval militia members, the total PERS, TRS, elected, and judicial officials' unfunded multi-employer actuarial

pension liability was \$7.07 billion as of June 30, 2011, which is 59% funded on a combined basis -- high in our view, at \$9,708 per capita, and 29% of total state personal income.

The state's defined-benefit OPEB liability for PERS was \$4.04 billion and 55.3% funded by health care trust funds as of the most recent, June 30, 2012, audit. This represents a marked improvement from 2009, when the funded ratio was 32% and the UAAL was \$8.6 billion. The OPEB liability also includes those of other participating local governments. The state is required by statute to fund the annual contributions to the pension system at the actuarially recommended level. The state's judicial retirement system had an unfunded OPEB of \$2.7 million, and the elected officials' retirement system had an unfunded OPEB of \$4.7 million. The TRS defined-benefit OPEB liability was 43.8% funded as of 2011, up from 29.5% as of 2009. At these levels, the OPEB UAAL for TRS was \$2.04 billion in 2010, down from \$3.20 billion in 2009. The combined state and local governmental employers' unfunded OPEB for PERS, STRS, and other plans equals a much smaller \$6.1 billion through 2011 as compared with the \$11.9 billion as of the 2009 valuation date.

Alaska reports its PERS unfunded OPEB costs for its legacy defined-benefit plan as part of its combined reporting of the defined-benefit pension system's unfunded retirement costs. PERS defined-benefit pension and OPEB contributions in fiscal 2012 equaled 78% of the combined annual required contribution (ARC) of \$745.5 million for the PERS pension and OPEB obligations. For TRS, the combined ARC for fiscal 2012 was \$335.7 million, of which the state and other employers contributed 80%, or \$272 million. However, on July 1 of each year or as soon as funds are available thereafter, the state is required by statute to contribute sufficient additional funds to bring the total pension contribution for the prior fiscal year to the ARC.

In addition to the state's direct debt, since 1970 Alaska has supported the bonds issued by pre-qualified school districts, with the legislature able to reimburse municipalities for 60% to 100% of debt service costs. The actual program funding depends on annual legislative appropriations, and although not contractually obligated to do so, Alaska has always made the payments. In fiscal 2012, it appropriated \$100.9 million of payments to school districts on total local school district obligations of approximately \$872.6 million.

The state also has about \$1.1 billion of self-supporting state moral obligation debt issued by the Alaska Bond Bank, the Alaska Energy Authority, and the Alaska Student Loan Corp.

On a four-point scale on which '1' is the strongest, Standard & Poor's has assigned a score of '2.4' to Alaska's debt and liability profile.

The Alaska Permanent Fund

Recognizing that over the long term the state's oil reserves would eventually be depleted, voters approved in 1976 a constitutional amendment to effectively monetize the state's natural resource assets. Since then, the state has managed an investment fund that is one of the largest of its kind in the world although principal balances are not available for budgetary purposes. Alaska's permanent fund is capitalized with royalties paid by oil companies.

The Alaska constitution requires that "at least 25% of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments, and bonuses received by the state will be placed in a permanent fund." The state

legislature subsequently added by statute another 25% deposit, raising the combined rate to 50%, on mineral leases issued after Dec. 1, 1979, and for bonuses on mineral leases issued after Feb. 15, 1990. The combined rate was reduced back to 25% as of July 1, 2003, but raised again to 50% on Oct. 1, 2008. The state legislature has also made special appropriations to the principal account from other oil revenue and fund earnings. As a result, the Alaska permanent fund balance increased to \$40.3 billion at the end of fiscal 2012 from an initial deposit of \$734,000 in 1977. This includes both \$38.3 billion restricted as to principal and the \$2 billion unrestricted PFER, representing cumulative permanent fund earnings and past transfers from other sources. The PFER can be spent for any purpose by a simple majority vote of the legislature.

Alaska residents, particularly in poor rural areas, reap significant economic benefits from the fund through the state's politically popular annual dividend program, under which a portion of the permanent fund's annual earnings is distributed as dividends to every resident of the state. In fiscal 2012, Alaska paid a permanent fund dividend of \$878 per state resident, not including PFER payments to maintain "dividend" payments to state residents. This is down from 2009, when the state paid a dividend payment of \$2,069 plus a one-time, \$1,200 per-resident "Alaska resource rebate" from accumulated nonrestricted permanent fund earnings reserves. Also, the state has made transfers to the PFER to "inflation-proof" the permanent fund's principal. PFER balances have also been paid out at other times to the general fund.

Before fiscal 2008, the permanent fund increased in every year except during the 2001-2002 bear market, when declines of 3% and 2%, respectively, were recorded. The permanent fund is managed by both the in-house staff of the state-owned Alaska Permanent Fund Corp. (established in 1980) and by external money managers.

Alaska's Oil Tax Structure

The state changed its method of taxing petroleum from a gross tax on petroleum production to a net income tax in 2006, with a modification in 2007 to its current form known as Alaska's Clear And Equitable Share (ACES). During the past several legislative sessions, the governor and legislature have debated various types of reforms to the state's tax regime, which ranks among the highest in the world, according to the state DOR. The current method of taxation was intended to promote exploration (by allowing for the deduction of development costs) while also generating more revenue for Alaska when oil prices are especially high. The tax is implemented at a progressive rate whereby the tax rate will rise with oil prices. The production tax rate is 25% of the value of the petroleum minus costs. A progressive surcharge of 0.4% is added for every dollar of per-barrel net income in excess of \$30, increased by 0.1% for every dollar of net income in excess of \$92.50. Alaska estimated previously that for every dollar that the per-barrel price of oil increased, the state would receive \$122 million to \$194 million in additional general purpose revenue. Although the current level of taxation has led to windfall-like revenue for the state in recent years of sustained higher oil prices, the DOR believes it discourages new development. In addition, under ACES various tax credits are granted to companies for certain types of expenditures. State officials are not clear that the tax credits are incentivizing enough exploration or development to warrant the estimated \$850 million to \$1 billion (in fiscal years 2013 and 2014, respectively) in forgone tax revenue. The governor, therefore, is supportive of reforming the oil tax structure to make it more globally competitive (less progressive with price) while encouraging new development. Specific elements of reforms he may

support would include incentives for oil fields with special challenges, such as location far from existing infrastructure.

Related Criteria And Research

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Moral Obligation Bonds, June 27, 2006
- State And Local Government Ratings Are Not Directly Constrained By That Of The U.S. Sovereign, Aug. 8, 2011

Ratings Detail (As Of January 7, 2013)

Alaska GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Alaska certs of part (Seafood & Food Safety Lab Fac) ser 2003A dtd 08/01/2003 due 01/15/2005-2019		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Alaska COPs ser 2005A		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Alaska COPs (State Virology Lab Facs)		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed
Alaska Energy Auth, Alaska		
Alaska		
Alaska Energy Auth (Alaska) pwr rev (Bradley Lake Hydroelectric Proj)		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Alaska Mun Bnd Bank, Alaska		
Alaska		
Alaska Mun Bnd Bank (Alaska) GO		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO moral oblig (MBIA) (National)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO (AMBAC)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO (Moral Ob)		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Alaska Mun Bnd Bank GO		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Alaska Mun Bnd Bank (Alaska) GO		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Anchorage Municipality, Alaska		
Alaska		
Anchorage Municipality (Alaska) lse rev rfdg bnds (Correctional Facility) ser 2005		
<i>Unenhanced Rating</i>	AA+(SPUR)/Stable	Affirmed

Ratings Detail (As Of January 7, 2013) (cont.)

Matanuska-Susitna Boro, Alaska

Alaska

Matanuska-Susitna Boro (Alaska) lse rev (Goose Creek Correctional Facs) (ASSURED GTY)

Unenhanced Rating

AA+(SPUR)/Stable

Affirmed

Many issues are enhanced by bond insurance.

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McGRAW-HILL

FitchRatings

Fitch Rates Alaska's \$165MM GOs 'AAA'; Upgrades Outstanding GO Debt to 'AAA'

Ratings Endorsement Policy
07 Jan 2013 2:39 PM (EST)

Fitch Ratings-New York-07 January 2013: Fitch Ratings assigns an 'AAA' rating to general obligation (GO) bonds of the state of Alaska (the state), consisting of the following:

- \$11.945 million GO bonds, series 2013A (taxable qualified school construction bonds - direct payment);
- \$153.215 million GO bonds, series 2013B.

The bonds are expected to sell via negotiation the week of Jan. 14, 2013.

Fitch upgrades to 'AAA' from 'AA+' the rating on approximately \$575.8 million of outstanding state of Alaska GO bonds.

In addition, Fitch upgrades the ratings on the state's appropriation-backed debt and other related debt, which are detailed at the end of this release.

The Rating Outlook is Stable.

SECURITY

General obligations to which the full faith, credit and resources of the state are pledged.

KEY RATING DRIVERS

VERY LARGE RESERVES: Alaska has set aside very large reserves for general fund operating needs, principally in the Constitutional Budget Reserve Fund (CBR) and Statutory Budget Reserve Fund (SBR). The state has used recent windfalls from high oil prices to repay past CBR draws and remains committed to maintaining sizable reserves, a key rating factor given forecasted declines in oil production over time. The state's reserves provide multiple times coverage of its debt obligations.

CONSERVATIVE FINANCIAL MANAGEMENT: Conservative financial management is critical given the state's dependency on energy-related revenues and the volatility of energy prices and production. Fitch expects Alaska to prudently manage its reserve funds and promptly adjust its expenditures as needed, consistent with the state's historical practice.

ECONOMY AND FINANCES DEPENDENT ON NATURAL RESOURCES: While both natural resources and the federal government have provided sources of employment and income to Alaska's small population, the volatility inherent in the natural resource industry is the state's area of vulnerability. Petroleum-related revenue accounts for approximately 92% of unrestricted General Fund revenue.

MANAGEABLE LIABILITY POSITION: Alaska's debt burden is moderate. The state has prudently used available cash to fund its capital needs and cash-defeased outstanding obligations when cost-effective. Although the funded ratios of Alaska's major statewide pension systems are weak, the state has undertaken significant pension reforms and closed its defined benefit plans to new employees in 2006. In addition, about half of the state's other post-employment benefit (OPEB) obligations are pre-funded.

CREDIT PROFILE

The upgrade of Alaska's GO rating to 'AAA' from 'AA+' reflects the state's maintenance of very substantial and growing reserve balances and the continuation of conservative financial management practices at a time of strong revenue

performance. State revenues are linked closely to oil production from the North Slope and global petroleum price trends, exposing the state to significant revenue volatility. Mitigating this risk, state fiscal practices are generally conservative, with the state dedicating a substantial share of oil-related revenue to reserves and employing long-range forecasting of revenues and expenses. Reserve balances have grown exponentially over the past several fiscal years, and Fitch believes the state is committed to keeping reserve levels high. Development of a natural gas pipeline from the North Slope, completion of which would help diversify state revenues, continues, with a settlement agreement reached with several large gas developers in March 2012. Debt practices are conservative, with limited issuance and average amortization. The economy remains stable. Although the state has potential exposure to federal employment cutbacks tied to budget pressures at the federal level, its revenue system limits its budget exposure.

RESOURCE-DEPENDENT REVENUE SYSTEM

Alaska's economic and financial performance is tied closely to its natural resource base, with 92% of unrestricted general fund revenues derived from petroleum-related activity estimated for fiscal year (FY) 2013. Fluctuating global energy prices in 2007, 2008, and 2009, led to sharp surges and drops in the state's unrestricted general fund revenues in the related fiscal years. Revenues have grown sizably since fiscal 2009 along with petroleum prices, enabling sizable growth in the state's various reserve funds. The CBR and SBR together have grown from \$8.1 billion in FY 2009 to \$15.9 billion in FY 2012 and the fund balance of the state's permanent fund has increased from \$29.9 billion to \$40.3 billion over this same time frame.

FY 2012 North Slope West Coast oil prices averaged \$112.65 per barrel; well over the \$94.70 per barrel forecast on which the budget was based. On a GAAP basis, FY 2012 ended on June 30 with a \$3.8 billion general fund surplus, bringing the general fund balance to \$21.6 billion; more than 2 times total general fund expenditures. In addition, there was a \$192.8 million net positive fund balance change in the state's permanent fund, increasing the fund to \$40.3 billion. The fall 2012 forecast projects FY 2013 oil prices at \$108.67 per barrel; down from the \$110.44 per barrel on which the budget was based. The revised estimate for oil production is also slightly lagging forecast in FY 2013; 0.553 bbl/day now anticipated, down from 0.563 bbl/day forecast.

The fall 2012 revenue forecast points to unrestricted general fund revenue in FY 2013 landing behind budget due to these lagging results. FY 2013 unrestricted general fund revenues are forecast at \$7.57 billion, as compared to \$7.7 billion in anticipated expenditures. The state maintains several options to close this modest forecast gap in addition to reducing discretionary expenditures, such as capital projects and statewide supplemental expenses.

The governor recently proposed a fiscal 2014 operating budget that forecasts oil prices increasing slightly to \$109.61 per barrel, with a slight decline in oil production assumed. Fiscal 2014 unrestricted general fund revenues are forecast at \$7 billion, a 6.8% decline from anticipated revenues in FY 2013. The proposed \$6.5 billion in recurring and discretionary appropriations is 14.3% less than the prior year, primarily due to a \$1.1 billion proposed cut in capital expenditures. The proposal includes a \$508 million transfer to the SBR. The budget proposal will be considered in the 2013 legislative session. Fitch also expects the governor to pursue reforms to the oil tax structure, with the goal of encouraging additional investment and drilling to increase future oil production, and will review the details as they emerge.

VERY LARGE RESERVE FUNDS

As noted above, the state has prudently set aside much of its revenue windfall in the CBR and SBR. Deposits of surplus funds as well as dedicated petroleum dispute settlement funds have brought the CBR's balance to over \$11 billion. The SBR has grown to \$5.5 billion and over \$1 billion has been set aside for prefunding school formula payments. Additional balances available to the state include realized earnings of the \$40.3 billion Alaska Permanent Fund, measuring almost \$3 billion. These reserves may be accessed by the state by a majority vote of the legislature; with access to the CBR restricted to a three-fourths majority vote of the legislature should the general fund not be in a deficit situation. The pre-funded balance for education, equal to about one year of education expense, does not require a vote of the legislature for its use.

The state's fall 2012 forecast of increasing future oil prices combined with declines in production is expected to result in fairly steady but modest unrestricted general fund revenue losses through the FY 2022 forecast period. Should the state take no action to reduce its recurring and discretionary general fund expenditures and baseline spending growth continue, the state forecasts General Fund operating deficits would begin in FY 2015 and grow through the forecast period (FY 2022), resulting in the use of the SBR through the period of the forecast to balance operations until the reserve is depleted in FY 2020.

In the forecast, the CBR continues to grow through the forecast period until 2021, peaking at \$16 billion. The permanent fund earnings reserve (PFER) is also expected to grow through the forecast period, reaching \$7 billion in FY 2022. On a combined basis, these three reserve funds have a forecast peak of \$23 billion in FY 2019, declining to \$21 billion in FY

2022. General fund expenses in FY 2022 are forecast at \$8.6 billion, compared to \$7.7 billion in the current fiscal year and \$6.5 billion proposed for FY 2014. Fitch expects the state to prudently manage the application of these reserves, if such action is warranted, and realign its discretionary expenditures as necessary.

MANAGEABLE LIABILITY POSITION

The state is an infrequent debt issuer, meeting most capital needs from current revenues. The debt burden as of June 30, 2012 is manageable, with \$894 million in net tax-supported debt measuring 2.7% of personal income after excluding guaranteed debt of the Housing Finance Corporation, which has never required state support, and reimbursable school debt. The debt burden will increase to 3.2% when including the current issue. Expected borrowing for state transportation projects will also increase the debt to per capita income ratio, although Fitch notes that as the majority of state debt is repaid from petroleum-related revenue the debt-to-income ratio is not as meaningful for Alaska as for other states.

The pensions for two major statewide systems, for general public employees and for teachers, were funded at 63% and 54.1%, respectively, as of June 30, 2011 based on the systems' 8% investment return assumption. Using Fitch's more conservative 7% assumption, the funded ratios decline to 56.2% and 48.9%, respectively. OPEBs alone are funded at 50.4% for general public employees and 48.1% for teachers, as of June 30, 2011. The state has undertaken multiple pension reforms in recent years, including switching to a defined contribution plans for new employees beginning July 1, 2006 and legislation enacted in 2007 obligating the state to assume local governments' contributions over a fixed percentage of payroll. Additional pension reform discussions are ongoing and Alaska has no stated plan to issue up to \$5 billion in pension obligation bonds that were authorized in 2008.

As noted above, Fitch upgrades the ratings on the state's appropriation-backed debt and other related debt, which are listed below:

- Approximately \$11.4 million state of Alaska state certificates of participation to 'AA+' from 'AA';
- Approximately \$16 million municipality of Anchorage state lease revenue bonds to 'AA+' from 'AA';
- Approximately \$216 million Matanuska-Susitna Borough state lease revenue bonds to 'AA+' from 'AA';
- Approximately \$600 million Alaska Municipal Bond Bank GO bonds (2005 bond resolution) to 'AA+' from 'AA';
- Approximately \$4.6 million Alaska Municipal Bond Bank GO bonds (2010 bond resolution) to 'AA' from 'AA-'; and
- Approximately \$47.8 million Alaska Municipal Bond Bank bonds issued under various bond resolutions to 'AA' from 'AA-'.

The Rating Outlook is Stable.

State certificates of participation and state lease revenue bonds are backed by the state's appropriation commitment for debt service and therefore rated one notch below the state's GO rating.

State bond bank obligations incorporate multiple layers of security on both the borrower level and at the state level. For additional information on the bond bank, please see 'Fitch Rates Alaska Municipal Bond Bank GOs 'AA' dated Sept. 11, 2012.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from IHS Global Insight.

Applicable Criteria and Related Research:

--'Tax-Supported Rating Criteria', dated Aug. 14, 2012;

--'U.S. State Government Tax-Supported Rating Criteria', dated Aug. 14, 2012.

Applicable Criteria and Related Research:

Tax-Supported Rating Criteria

U.S. State Government Tax-Supported Rating Criteria

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ALASKA PERMANENT FUND

Balance Sheets

Unaudited (millions of dollars)	December 31, 2012	June 30, 2012
Assets		
Cash and temporary investments	\$ 1,673.3	1,995.6
Receivables, prepaid expenses and other assets	169.8	506.8
Investments —		
Marketable debt securities	7,666.8	7,568.7
Preferred and common stock	18,941.6	17,425.0
Real estate	5,124.5	4,387.1
Real return	3,133.1	2,924.2
Absolute return, mezzanine debt, distressed and credit opps	3,757.7	3,582.2
Private equity	1,934.2	1,712.9
Infrastructure	784.0	863.2
Emerging markets total opportunities	872.3	524.8
Alaska certificates of deposit	217.8	217.8
Total investments	<u>42,432.0</u>	<u>39,205.9</u>
TOTAL ASSETS	\$ 44,275.1	41,708.3
Liabilities		
Accounts payable	\$ 620.3	752.9
Income distributable to the State of Alaska	<u>0.0</u>	<u>622.3</u>
TOTAL LIABILITIES	620.3	1,375.2
Fund Balances		
Nonspendable:		
Permanent Fund corpus - contributions and appropriations	35,475.0	35,032.5
Not in spendable form - unrealized appreciation on invested assets	<u>4,550.5</u>	<u>3,220.0</u>
Total nonspendable	40,025.5	38,252.5
Committed:		
Current FY dividend	433.0	0.0
Current FY inflation proofing	703.0	0.0
Current FY AK Capital Income Fund	<u>13.3</u>	<u>0.0</u>
Total committed	1,149.3	0.0
Assigned for future appropriations:		
Realized earnings	2,067.4	1,905.5
Unrealized appreciation on invested assets	<u>412.6</u>	<u>175.1</u>
Total assigned	2,480.0	2,080.6
TOTAL FUND BALANCES	43,654.8	40,333.1
TOTAL LIABILITIES AND FUND BALANCES	\$ 44,275.1	41,708.3

ALASKA PERMANENT FUND

Statements of Revenues, Expenditures and Changes in Fund Balances

Unaudited (millions of dollars)	Month ended December 31, 2012	Six months ended December 31, 2012	Fiscal year-end audited June 30, 2012
Revenues			
Interest	\$ 22.2	130.0	297.2
Dividends	90.3	248.5	476.4
Real estate and other income	27.9	114.4	214.8
Total interest, dividends, real estate and other income	140.4	492.9	988.4
Net increase (decrease) in the fair value of investments			
Marketable debt securities	(11.2)	201.7	256.2
Preferred and common stock	399.9	1,638.1	(1,658.9)
Real estate	8.3	79.1	221.8
Real return	24.9	190.7	126.7
Absolute return, credit opps, distressed and mezzanine debt	4.3	105.8	0.3
Private equity	(9.1)	69.5	134.5
Infrastructure	21.4	63.2	(77.8)
Emerging markets total opportunities	19.8	53.9	(74.9)
Forward exchange contracts and equity futures	16.6	47.0	24.7
Currency	(0.2)	(12.6)	57.4
Total net increase (decrease) in investments	474.7	2,436.4	(990.0)
TOTAL REVENUES	615.1	2,929.3	(1.6)
Expenditures			
Operating expenditures	(7.8)	(43.6)	(91.3)
Other legislative appropriations	0.0	(6.4)	(7.0)
TOTAL EXPENDITURES	(7.8)	(50.0)	(98.3)
Excess (deficiency) of revenue over expenditures	\$ 607.3	2,879.3	(99.9)
Other Financing Sources (Uses)			
Transfers in	68.5	442.4	915.1
Transfers out	0.0	0.0	(622.3)
NET CHANGE IN FUND BALANCES	675.8	3,321.7	192.9
Fund Balances			
Beginning of period	42,979.0	40,333.1	40,140.2
End of period	\$ 43,654.8	43,654.8	40,333.1

Statutory Income Calculation

Excess (deficiency) of revenues over (under) expenditures	607.3	2,879.3	(99.9)
Adjustments to bring net income to statutory net income:			
Unrealized (gains) losses	(238.7)	(1,568.0)	1,685.0
Alaska Capital Income Fund realized income	(3.7)	(13.3)	(17.1)
STATUTORY NET INCOME	\$ 364.9	1,298.0	1,568.0

ALASKA PERMANENT FUND

Receivables and Payables

Unaudited (millions of dollars)	December 31, 2012
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Accounts Receivable

Interest Receivable	\$ 61.8
Dividends Receivable	27.6
Pending Sales Fixed Income	6.5
Pending Sales Equities	11.0
Pending Sales Alternative Investments	0.0
State Dedicated Revenues Receivable	62.0
Pending Sales Real Estate/REITs	0.9
Prepaid and Other Receivables	0.0
TOTAL RECEIVABLES	<u>\$ 169.8</u>

Accounts Payable

Accrued Operating Payables	\$ 20.0
Pending Purchase Fixed Income	581.0
Pending Purchase Equities	19.1
Pending Purchase Real Estate/REITs	0.2
TOTAL PAYABLES	<u>\$ 620.3</u>



ALASKA PERMANENT FUND FUND FINANCIAL HISTORY & PROJECTIONS as of December 31, 2012

Projections extend ten years, and are based on best available information (\$ in millions)

Nonspendable Fund Balance - Principal										Assigned Fund Balance										TOTAL FUND	
FY	FY-Begin Contrib. Balance	Appro- ⁽¹⁾ priations	Dedicated ⁽²⁾		FY-End Balance Contributions	Unrealized Gain (Loss) ³		FY-End Non-spendable Balance	Acct. Net Income ⁽⁴⁾	Statutory Net Income ⁽⁵⁾	Distributions of Statutory Net Income			FY-End Balance Realized	Unrealized Gain (Loss)		Net Assigned Change	FY-End Assigned Balance	FY		FY-End Balance
			State Revenues	Inflation Proofing		Net Change	FY-End Balance				Dividends	Inf-Proofing / Other ⁽⁶⁾	Gen. Fund / Other ⁽⁶⁾		Net Change	FY-End Balance ⁽⁷⁾					
77-03	0	7,378	7,726	7,884	22,988	1,106	1,106	24,094	24,502	25,244	12,535	11,979	282	100	0	0	(1,035)	100	77-03	24,194	
04	22,988	(339)	353	524	23,526	1,909	3,015	26,541	3,434	1,502	581	170	0	859	0	0	759	859	04	27,400	
05	23,526	0	480	641	24,647	859	3,874	28,522	2,640	1,754	532	641	27 ⁽⁸⁾	1,440	0	0	581	1,440	05	29,962	
06	24,647	0	601	856	26,104	347	4,221	30,325	3,072	2,689	689	856	37	2,585	0	0	1,145	2,585	06	32,910	
07	26,104	0	532	860	27,497	1,977	6,198	33,694	5,448	3,429	1,022	860	42	4,132	0	0	(1,505)	4,132	07	37,826	
08	27,497	0	844	808	29,149	(3,886)	2,064	31,213	(1,372)	2,938	1,293	808	33	4,969	352	352	1,189	5,321	08	36,534	
09	29,149	0	651	1,144	30,944	(3,513)	(1,449)	29,496	(6,394)	(2,509) ⁽⁹⁾	875	1,144	0 ⁽⁹⁾	441	(373)	(21)	(4,901)	420	09	29,916	
10	30,944	0	679	0 ⁽⁹⁾	31,624	1,869	421	32,045	3,517	1,590 ⁽⁹⁾	858	0 ⁽⁹⁾	0 ⁽⁹⁾	1,194	37	16	790	1,210	10	33,255	
11	31,624	0	887	533	33,044	4,367	4,788	37,832	6,812	2,143 ⁽⁹⁾	801	533	13 ⁽⁹⁾	2,016	276	292	1,098	2,308	11	40,140	
12	33,044	0	915	1,073	35,033	(1,568)	3,220	38,253	(100)	1,568	605	1,073	17	1,905	(117)	175	(227)	2,081	12	40,333	
10%	35,033	0	796	896	36,724	(3,981)	(761)	35,963	(3,107)	1,072	409	896	13	1,673	(210)	(35)	(443)	1,638	13	37,601	
25%	35,033	0	796	896	36,724	(1,669)	1,551	38,276	(427)	1,322	436	896	15	1,896	(95)	80	(105)	1,976	13	40,251	
Mid	35,033 ⁽⁹⁾	0	796 ⁽⁹⁾	896 ⁽⁹⁾	36,724	984	4,204	40,928	2,726 ⁽⁹⁾	1,648	470	896	19	2,188	75	250	358	2,438	13	43,366	
25%	35,033	0	796	896	36,724	3,780	7,000	43,725	6,127	2,019	509	896	23	2,520	305	480	920	3,000	13	46,725	
10%	35,033	0	796	896	36,724	6,363	9,583	46,308	9,349	2,390	548	896	26	2,852	569	744	1,515	3,596	13	49,904	
14	36,724	0	833	939	38,496	682	4,886	43,382	2,936	2,169	958	939	22	2,460	62	312	334	2,773	14	46,155	
15	38,496	0	821	983	40,300	720	5,606	45,906	3,127	2,313	1,033	983	22	2,757	71	384	368	3,141	15	49,047	
16	40,300	0	816	1,028	42,144	753	6,359	48,503	3,326	2,462	1,067	1,028	22	3,125	88	472	455	3,596	16	52,100	
17	42,144	0	768	1,073	43,985	795	7,155	51,140	3,534	2,619	1,177	1,073	22	3,494	97	568	466	4,063	17	55,202	
18	43,985	0	711	1,117	45,813	840	7,994	53,808	3,745	2,778	1,296	1,117	22	3,859	105	673	470	4,532	18	58,340	
19	45,813	0	658	1,162	47,633	878	8,872	56,505	3,959	2,939	1,377	1,162	22	4,259	120	793	520	5,052	19	61,557	
20	47,633	0	620	1,206	49,459	916	9,787	59,247	4,178	3,104	1,460	1,206	22	4,697	136	929	574	5,626	20	64,873	
21	49,459	0	580	1,251	51,291	953	10,741	62,031	4,405	3,274	1,545	1,251	22	5,175	154	1,084	633	6,259	21	68,290	
22	51,291	0	545	1,296	53,131	991	11,732	64,863	4,638	3,450	1,632	1,296	22	5,697	174	1,258	697	6,955	22	71,819	
23	53,131	0	505	1,341	54,977	1,029	12,761	67,738	4,879	3,631	1,722	1,341	22	6,266	196	1,454	765	7,720	23	75,458	
Cumulative Totals																					
Proj. for 2013-2023										0 7,653 12,292 9,541										41,452 30,389 13,737 12,292 244 1,279 5,639	

Assumptions:	Total Return - Inflation = Total Real Return	Statutory Return			
10% FY 2013	-7.32%	2.50%	-9.82%	10%	2.97%
25% FY 2013	-0.74%	2.50%	-3.24%	25%	3.59%
Mid FY 2013 ⁽⁹⁾	7.00%	2.50%	4.50%	Mid	4.40%
25% FY 2013	15.35%	2.50%	12.85%	25%	5.32%
10% FY 2013	23.26%	2.50%	20.76%	10%	6.24%
FY 2014-2023⁽⁹⁾	7.00%	2.50%	4.50%		5.30%

Notes related to financial history and projections FY1977 - FY2023

- ⁽¹⁾ Appropriations include special general fund, realized earnings, and other miscellaneous appropriation transfers into principal.
- ⁽²⁾ Dedicated State Revenues in current and future fiscal years are based on the Fall 2012 Department of Revenue forecast.
- ⁽³⁾ Accounting net income is based on United States Generally Accepted Accounting Principles (GAAP). Statutory net income is accounting net income, excluding any unrealized gains and losses on investments, and excluding earnings of the Alaska Capital Income Fund (AM Hess, et al principal).
- ⁽⁴⁾ FY05 and forward, Amerada Hess, et al. annual net positive settlement earnings are transferred to Alaska Capital Income Fund (ACIF) per AS 37.13.145(d).
- ⁽⁵⁾ Beginning in FY08, based on legal opinion, unrealized gains and losses were allocated between the nonspendable fund balance (principal) and the assigned fund balance (earnings reserve). Prior to FY08, all unrealized gains and losses were included with principal.
- ⁽⁶⁾ Current year returns and inflation are based on 2012 Callan capital market assumptions.
- ⁽⁷⁾ Future returns are based on 2012 Callan capital market assumptions and median expected returns (the mid case). Actual results will vary.
- ⁽⁸⁾ During FY 2009, the ACIF realized losses of \$33.3 million, which are excluded from statutory net income, and are included in the ending unreserved balance as a deficit account. During FY 2010 and FY 2011, the ACIF had realized income of \$20.8 and \$25.3 million, which is excluded from statutory net income, and served to reduce the FY 2009 deficit.
- ⁽⁹⁾ The statutory inflation calculation for FY 2010 was -.36%; therefore, there was no inflation proofing transfer during FY 2010.
- ⁽¹⁰⁾ FY77-02 includes special appropriations to principal of \$4 billion

Income year-to-date as of December 31, 2012

FY13 Statutory net income	
Interest, dividends, real estate & other income	\$ 492.9
Realized gains (losses) on the sale of invested assets	868.4
Less operating exp / Legis. Appropriations	(50.0)
Less AK Capital Inc. Fund committed realized earnings	(13.3)
Statutory net income (loss)	\$ 1,298.0

FY13 Accounting (GAAP) net income	
Statutory net income (loss)	\$ 1,298.0
Unrealized gains (losses) on invested assets	1,568.0
AK Capital Income Fund committed realized earnings	13.3
Accounting (GAAP) net income (loss)	\$ 2,879.3

PERFORMANCE SUMMARY (preliminary as of December 31, 2012)	Current	Last 3	Fiscal	Calendar	Last 12	Last 3	Last 5
	Month	Months	Y-T-D	Y-T-D	Months	Years	Years
Domestic Fixed Income	-0.05%	0.85%	3.30%	7.20%	7.20%	7.04%	6.34%
Non-Domestic Fixed Income	0.09%	1.02%	2.92%	5.31%	5.31%	4.72%	4.80%
Domestic Equities	1.42%	0.74%	6.98%	16.64%	16.64%	11.18%	2.63%
Non-Domestic Equities	3.52%	5.75%	13.69%	17.05%	17.05%	4.04%	-2.82%
Global Equities	2.73%	3.73%	10.95%	17.17%	17.17%	7.96%	-0.93%
Real Estate	0.33%	1.84%	3.80%	9.82%	9.82%	10.26%	1.50%
Private Equity	N/M	3.86%	5.08%	15.20%	15.20%	15.54%	6.08%
Absolute Return	0.79%	1.45%	3.85%	7.61%	7.61%	4.83%	1.63%
Infrastructure	N/M	7.32%	8.42%	-1.45%	-1.45%	7.18%	
External CIO/Real Return Mandate	1.15%	2.10%	7.18%	11.85%	11.85%		
American Homes 4 Rent	0.00%	0.00%					
Total Fund	1.54%	2.67%	7.34%	12.58%	12.58%	8.15%	2.27%