FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Anchorage, AK's 2024 GO Bonds 'AA'; Outlook Stable; Removed from UCO

Fri 19 Jul, 2024 - 5:20 PM ET

Fitch Ratings - San Francisco - 19 Jul 2024: Fitch Ratings has assigned a 'AA' rating to the following municipality of Anchorage, Alaska general obligation (GO) bonds:

--$80.2 million 2024 GO Bonds, Series A (General Purpose);

--$65.2 million 2024 GO Bonds, Series B (Schools).

Fitch has also affirmed the following ratings:

--Municipality of Anchorage Issuer Default Rating (IDR) at 'AA';

--Various GO and GO refunding bonds issued by the Municipality of Anchorage at 'AA';

--Certificates of Participation (COPs) issued by the Municipality of Anchorage at 'AA-'; and

--Anchorage Convention Center revenue refunding bonds issued by CIVICVentures at 'AA-'.

The Rating Outlook is Stable. The ratings on the GO bonds, GO refunding bonds, COPS, along with the IDR, have been removed from Under Criteria Observation.

The bonds will price competitively the week of July 22. Bond proceeds will be used for ongoing capital improvement programs of the municipality and its school district.

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR

Municipality of Anchorage (AK) [General Government]	LT IDR	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Municipality of Anchorage (AK) /General Obligation - Unlimited Tax/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Municipality of Anchorage (AK) /Lease Obligations - Standard/1 LT	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable
Municipality of Anchorage (AK) /Tourism Tax Revenues/1 LT	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The 'AA' IDR and GO bond rating reflects the implementation of Fitch's new U.S. Public Finance Local Government Rating Criteria. The IDR incorporates the municipality's 'a' financial resilience given expected fund balance levels equal to at least 7.5% of general fund spending and a 'midrange' budgetary flexibility assessment. The municipality paid upfront costs to address damage from a 2018 earthquake and the coronavirus pandemic, with the expectation these costs would be largely reimbursed by state and federal resources.

These upfront costs depleted unrestricted general fund reserves to -$9.6 million (-1.6% of general fund spending) in fiscal 2021 (December 31 YE) and recovery is expected to be a years-long process. Reimbursements took place in fiscal 2022 which boosted unrestricted general fund reserves to 3.2% of spending, and the city projects further improvement in reserves nearing 10% for year-end fiscal 2023. The municipality has a 12% unrestricted reserve policy. Achieving this policy will be dependent on strict budgetary maintenance of aligning expenditures with revenues and the speed of the remaining reimbursements.

The municipality strictly adhered to its policy prior to the 2018 earthquake. Audited year-end fiscal 2023 results will be delayed due to an extended delay for the municipality's fiscal

2022 audit. Management reports the delay was in part due to a high turnover in the finance department, slow ability to hire new staff, alongside a heavy workload documenting the reimbursements in preparation for the audit. The delayed fiscal 2022 audit caused some concern in the municipality receiving approximately $20 million reimbursements from the state for various healthcare costs, but management believes the recent completed audit will eliminate those concerns.

The 'AA' IDR and GO ratings also reflect Anchorage's 'weakest' demographic and economic trend metrics, given the municipality's recently declining population driven primarily by the energy and government sectors. The energy sector is rebounding due to energy price increases, which is beginning to show a slight turnaround in the municipality's population. The rating also factors in the municipality's 'weak' long-term liability burden composite.

The IDR and GO ratings include an additional analytical factor of +1.0 notch for economic and institutional strength, as the municipality serves as the population hub of the state, as well as home to numerous institutional anchors including a large military presence, robust healthcare sector, and the state's largest university.

The 'AA-' COP rating is one notch lower, reflecting a slightly higher degree of optionality associated with appropriation debt.

The 'AA-' rating on the CIVICVentures hotel tax revenue bonds reflect Fitch's dedicated tax analysis, including the structure's solid resilience to expected revenue volatility, assessed at 'aa', evidenced by a solid debt service cushion, robust pledged and restricted reserves, and limited future issuance expectations. The rating also considers the pledged revenues 'aa' level growth prospects and an asymmetric risk given the taxpayer concentration. The CIVICVentures hotel tax revenue bonds' ratings are capped at the municipality's IDR.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

For the IDR, GO bonds, and COPS:

--Lack of progress to improve and sustain unrestricted general fund reserves at least equal to 7.5% of spending, which would result in a change in the financial resilience assessment to 'a' or lower;

--Though unexpected, prolonged delays in the release of the municipality's audited financial statements;

--A nearly 20% increase in long-term liability burden, assuming no changes in the personal income levels or governmental expenditures and revenues.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

For the CIVICVentures Bonds:

--Sustained deteriorations in the revenue growth prospects and/or debt service coverage cushion to below 1.8x maximum annual debt service;

--Downgrade of the municipality's IDR below 'AA-'.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

For the IDR, GO Bonds, and COPs:

--In conjunction with a timely completion of future audits, improved financial resilience assessment evidenced by the municipality maintaining reserves at or above 10%, the threshold for a 'aa' financial resilience assessment for issuers with 'midrange' budgetary flexibility;

--A nearly 30% decrease in the long-term liability burden, assuming no changes in personal income levels or governmental expenditures and revenues.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

For the CIVICVentures Bonds:

--Material increases in the revenue growth trends and resulting debt service cushion to maximum annual debt service (MADS) coverage of 2.4x;

--Significant diversification of the currently concentrated taxpayer base, which Fitch believes is unlikely due to the size of the hotel market.

SECURITY

The GO bonds are payable from an unlimited ad valorem property tax levy on all taxable property in the municipality.

The COPs are payable from lease payments made by the municipality for occupancy of a variety of governmental assets. The municipality has covenanted to include the lease payments in the annual budgets presented to Municipal Assembly, while the Municipality's obligation to make the lease payments is subject to appropriation by the Municipal Assembly. The lease obligations are not subject to abatement.

The convention center CIVICVentures revenue bonds are payable from a gross pledge of a portion of the municipality's hotel tax revenues.

FITCH'S LOCAL GOVERNMENT RATING MODEL

The Local Government Rating Model generates Model Implied Ratings which communicate the issuer's credit quality relative to Fitch's local government rating portfolio (the Model Implied Rating will be the IDR except in certain circumstances explained in the applicable criteria). The Model Implied Rating is expressed via a numerical value calibrated to Fitch's long-term rating scale that ranges from 10.0 or higher ('AAA'), 9.0 ('AA+'), 8.0 ('AA'), and so forth down to 1.0 ('BBB-' and below).

Model Implied Ratings reflect the combination of issuer-specific metrics and assessments to generate a Metric Profile, and a structured framework to account for Additional Analytical Factors not captured in the Metric Profile that can either mitigate or exacerbate credit risks. Additional Analytical Factors are reflected in notching from the Metric Profile and are capped at +/-3 notches.

RATINGS HEADROOM & POSITIONING

Municipality of Anchorage Model Implied Rating: 'AA' (Numerical Value: 8.42)

-- Metric Profile: 'AA-' (Numerical Value: 7.42)

-- Net Additional Analytical Factor Notching: +1.0

Individual Additional Analytical Notching Factors:

-- Economic and Institutional Strength: +1.0

Municipality of Anchorage's Model Implied Rating is 'AA'. The associated numerical value of 8.42 is in the middle of the 8.0 to 9.0 range for its current 'AA' rating.

KEY RATING DRIVERS

FINANCIAL PROFILE

Financial Resilience - 'a'

Municipality of Anchorage's financial resilience is driven by the combination of its 'Midrange' revenue control assessment and 'Midrange' expenditure control assessment, culminating in a 'Midrange' budgetary flexibility assessment.

-- Revenue control assessment: Midrange

-- Expenditure control assessment: Midrange

-- Budgetary flexibility assessment: Midrange

-- Minimum fund balance for current financial resilience assessment: >=7.5%

-- Current year fund balance to expenditure ratio: 3.2% (2022)

-- Five-year low fund balance to expenditure ratio: 7.5% Analyst Input (vs. -1.6% 2022 Actual)

Revenue Volatility - 'Midrange'

Municipality of Anchorage's weakest historic three-year revenue performance has a modest negative impact on the Model Implied Rating.

The revenue volatility metric is an estimate of potential revenue volatility based on the issuer's historical experience relative to the median for the Fitch-rated local government portfolio. The metric helps to differentiate issuers by the scale of revenue loss that would have to be addressed through revenue raising, cost controls or utilization of reserves through economic cycles.

-- Lowest three-year revenue performance (based on revenues dating back to 2005): 2.1% decrease for the three-year period ending fiscal 2017

-- Median issuer decline: -4.6% (2022)

Analyst Inputs to the Model

The 7.5% assumption balances Fitch's view that the 2018 earthquake and pandemic emergencies were one-time events and a forward-looking approach that incorporates fund balance projections rebounding within the 'a' financial resilience range. Ongoing budgetary control and federal reimbursements could restore fund balances to the municipality's fund balance policy of 12% of general fund expenditures and transfers out when excluding school district expenditures which, if sustained, could strengthen Fitch's financial resilience assessment.

DEMOGRAPHIC AND ECONOMIC STRENGTH

Population Trend - 'Weakest'

Based on the median of 10-year annual percentage change in population, Municipality of Anchorage's population trend is assessed as 'Weakest'.

Population trend: -0.7% Analyst Input (1st percentile) (vs. -0.5% 2021 median of 10-year annual percentage change in population)

Unemployment, Educational Attainment and MHI Level - 'Strong'

The overall strength of Municipality of Anchorage's demographic and economic level indicators (unemployment rate, educational attainment, median household income [MHI]) in 2022 are assessed as 'Strong' on a composite basis, performing at the 65th percentile of Fitch's local government rating portfolio. This is due to relatively high education attainment levels and median-issuer indexed adjusted MHI, midrange unemployment rate.

-- Unemployment rate as a percentage of national rate: 94.4% Analyst Input (55th percentile) (vs. 97.2% 2022), relative to the national rate of 3.6%

-- Percent of population with a bachelor's degree or higher: 37.0% Analyst Input (69th percentile) (vs. 36.8% 2021 Actual)

-- MHI as a percent of the portfolio median: 122.7% Analyst Input (73rd percentile) (vs. 120.7% 2021 Actual)

Economic Concentration and Population Size - 'Strongest'

Municipality of Anchorage's population in 2021 was of sufficient size and the economy was sufficiently diversified to qualify for Fitch's highest overall size/diversification category.

The composite metric acts asymmetrically, with most issuers (above the 15th percentile for each metric) sufficiently diversified to minimize risks associated with small population and economic concentration. Downward effects of the metric on the Metric Profile are most pronounced for the least economically diverse issuers (in the 5th percentile for the metric or lower). The economic concentration percentage shown below is defined as the sum of the absolute deviation of the percentage of personal income by major economic sectors relative to the U.S. distribution.

-- Population size: 289,169 (2021) (above the 15th percentile)

-- Economic concentration: 39.1% (2022) (above the 15th percentile)

Demographic and Economic Strength Additional Analytical Factors and Notching: +1.0 notch (for Economic and Institutional Strength)

As Alaska's largest city, the municipality is the center of business, trade, transportation, health care, education, government and tourism for the state of Alaska and serves as a strategic aviation and defense center for the U.S. military. The municipality is home to roughly 40% of the state's population with about 290,000 residents and produces more than half of the state's economic output with growth in personal income levels equaling a cumulative 12% over the prior five years

Analyst Inputs to the Model

The model defaulted to the 2022 data. Fitch made adjustments to the population, unemployment, education attainment, and income levels to include 2023 data.

LONG TERM LIABILITY BURDEN

Long-Term Liability Burden - 'Weak'

Municipality of Anchorage's liabilities to governmental revenue has deteriorated while carrying costs to governmental expenditures and liabilities to personal income remain moderately weak. The long-term liability composite metric in 2022 is at the 32nd percentile, indicating a somewhat elevated liability burden relative to the Fitch's local government rating portfolio.

-- Liabilities to personal income: 8.4% Analyst Input (27th percentile) (vs. 8.2% 2022 Actual)

-- Liabilities to governmental revenue: 198.0% Analyst Input (41st percentile) (vs. 194.6% 2022 Actual)

-- Carrying costs to governmental expenditures: 17.4% Analyst Input (32nd percentile) (vs. 19.3% 2022 Actual)

Analyst Inputs to the Model

The municipality's net direct debt was adjusted for outstanding principal amortized in fiscal 2023 and the inclusion of the proposed 2024 GO bonds. Debt service was also adjusted to include fiscal 2023 amounts and the first year of the 2024 GO bonds' debt service. The carrying cost model input incorporates debt service support from the state for school bonds, which state support has fluctuated in recent years.

DEDICATED TAX SECURITY

The convention center CIVICVentures revenue bonds are payable from a gross pledge of a portion of the municipality's hotel tax revenues.

DEDICATED TAX KEY RATING DRIVERS

Prior to the pandemic, pledged revenue growth was above inflation but below GDP. The pandemic had an outsized effect on the municipality's hotel taxes, evidenced by the 49% pledged revenue decline in fiscal 2020. Fiscal 2021 rebounded by 76% to $16.8 million, on par with fiscal 2018 levels but slightly below the pre-pandemic peak of $18.6 million in fiscal 2019. The continued return of visitors increased revenues by nearly 40% in fiscal 2022 to about $24 million. Fitch expects revenues will resume pre-pandemic growth between inflation and U.S. GDP.

Fiscal 2022 pledged revenues rebounded above pre-pandemic levels to $23.6 million, which covered MADS 3.3x. Fitch assumes leverage at 2.0x MADS given past borrowing practices (slightly above the 1.75x MADS ABT requirement). To evaluate the sensitivity of the pledged revenue stream to cyclical decline, Fitch analyzes the degree of coverage cushion that current revenues provide relative to both the revenue sensitivity results via the Fitch Analytical Stress Test (FAST) model in 1% GDP decline scenario, and the largest decline in revenues over the period covered by the revenue sensitivity analysis.

Fiscal 2022 pledged revenues could decline by approximately 70% before 1.0x MADS coverage. The 70% coverage cushion is about 7x the moderate recession scenario and approximately 1.0x the worst pledged revenue decline. The 'aa' financial resilience assessment considers the extraordinary nature of the pandemic, the largest pre-pandemic decline of approximated 10%, and the full rebound in pledged revenues and expectation that pledged revenues are considerably less volatile to typical cyclical stress.

The municipality holds approximately $32 million in its convention center fund that could be used for debt service in the event of another extraordinary stress. Annual debt service is level at about $6.8 million. The combination of a MADS revenue cushion and these available monies support the continued sound resilience assessment.

The dedicated taxes pledged to the bonds do not meet the requirements set out in Fitch criteria for treatment as "pledged special revenues" under section 902(2) of the bankruptcy code and are not otherwise insulated from the operating risk of the municipality. Therefore, the rating of the debt is capped at the IDR.

The municipality's total hotel tax rate is 12%. In 2005, voters authorized a four-percentage point (pp) increase in the municipality's room tax to 12%, and the issuance of revenue bonds supported by the hotel tax to construct a new convention center. The bonds are primarily payable from the 2005 4% convention center room tax. The Anchorage Convention and Visitor's Bureau (ACVB) has also pledged 66.25% of the four percentage points (pps) it receives from the municipality to promote tourism.

The municipality pledged $904,401 in fiscal 2023 from its remaining 4pps of room tax, which is increased or decreased each year by the percentage change in total hotel taxes collected for the prior year. The ACVB pledged another $1.1 million from its remaining room-tax revenues likewise to be increased or decreased each year by the percentage change in total hotel taxes collected for the prior year.

The rating also reflects the concentrated nature of the pledged revenues, which are dominated by the top 10 hotel taxpayers, as well as Anchorage's remoteness from the primary tourism customer base in the lower 48 states. The concentration of pledged-revenue payers limits the rating.

PROFILE

Anchorage's economy, like that of the state, is driven primarily by the energy and government sectors. Anchorage serves as the headquarters city for major oil and oilfield services companies doing business in the state. The sector also drives a significant degree of the municipality's construction, financial services, professional and business services, and retail sectors. The municipality also has significant tourism, health care, transportation and trade industries.

Summer is the primary tourism season in Alaska and 2020 was particularly challenging for Anchorage due to the lack of visitors from the lower 48 states and from outside the U.S. Hotel taxes plummeted by approximately 61% yoy but have recovered to exceed pre-pandemic levels by fiscal 2022 due to the full return of cruises, reopening of international borders, and robust traveling spending. Municipality estimates project continued growth in hotel taxes followed by a level trend for fiscal 2024.

The state's energy sector is highly cyclical and had been in gradual decline due to falling production in mature oil fields. While there are significant untapped oil and gas resources throughout the state that may be exploited in the future, such projects are quite sensitive to energy prices. Low oil prices in recent years led to reduced production and possible declines in population, but oil prices have rebounded leading to some players increasing investments in production.

Low oil prices also sharply reduced state revenues, which are driven by royalty payments. In contrast, most local revenues in Alaska are driven by changes in residential property values, which lag activity in the energy sector and broader economy and have been much more stable than state revenues historically. All told, local governments are exposed somewhat to changes in state aid to municipalities but at very minimal levels, approximating less than 1% for Anchorage general fund revenues when including pass through revenues to schools.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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APPLICABLE CRITERIA

U.S. Public Finance Local Government Rating Criteria (pub. 02 Apr 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

U.S. Local Government Rating Model, v1.2.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Municipality of Anchorage (AK)	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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