

# Research

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## Summary:

# Anchorage, Alaska; Appropriations; General Obligation

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# Anchorage, Alaska; Appropriations; General Obligation

### Credit Profile

US\$80.175 mil GO bnds ser 2024A due 09/01/2044

<i>Long Term Rating</i>	AA-/Stable	New
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US\$65.2 mil GO bnds ser 2024B due 09/01/2044

<i>Long Term Rating</i>	AA-/Stable	New
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Anchorage GO

<i>Long Term Rating</i>	AA-/Stable	Downgraded
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### Credit Highlights

- S&P Global Ratings lowered its rating to 'AA-' from 'AA' on Anchorage, Alaska's general obligation (GO) debt outstanding.
- At the same time, we lowered our rating to 'A+' from 'AA-' on the municipality's certificates of participation (COPs) debt outstanding.
- In addition, we assigned our 'AA-' rating to the Municipality of Anchorage's series 2024 A (approximately \$80.175 million) general-purpose GO bonds and series 2022 B (approximately \$65.2 million) school GO bonds.
- The outlook on all ratings is stable.
- The downgrade reflects our view of Anchorage's weakened financial management practices, as reflected in our revised financial management assessment (FMA) to standard from good, and a contributing factor to the trend of negative fund balances in the general fund in fiscal years 2021 and 2022, along with delayed release of the fiscal 2022 audited financial statement.

### Security

Anchorage's full faith credit and resources, including an obligation to levy ad valorem property taxes without limitation as to rate or amount, secure the GO bonds. Its COPs are payable from lease payments by the municipality for use and possession of the leased assets without the ability to abate payments, and our rating is set one notch below our view of the municipality's general creditworthiness due to appropriation risk. Under the lease agreement, Anchorage agreed to budget and appropriate for COP payments, which occur on Jan. 1 and July 1. Although the first payment occurs at the beginning of the fiscal year and no reserve fund is required, the municipality must adopt its proposed budget by Dec. 15 if its budget has not yet been adopted. In our view, this largely mitigates the risk of late payment.

Proceeds from the 2024 issuances will fund a variety of projects for public safety and transportation, roads, police, fire, and other facilities.

## **Credit overview**

The downgrade reflects recent weakening of Anchorage's financial position, which was, in part associated with management's lack of proactive adjustments to the budget to manage the declines. Unassigned reserves materially declined in fiscal 2021, reflecting multiple factors, including increased COVID-19 expenditures, revenue losses due to a drop in tourism, a delay in FEMA receipts from the 2018 earthquake, and an unexpected avalanche in the northern end of the municipality requiring up-front expenditures. While we understand that after natural disasters the FEMA reimbursement process can take time, in our view, the delay following the 2018 earthquake was unusually drawn out. While officials note that \$78 million in reimbursements toward COVID-19 expenditures have been received and should be reflected in the general fund in fiscal 2023, financial projections provided by the municipality in recent years have been off the mark, and 2023 financial statements are not yet available. Officials' projections originally stated that 2022 reserves would recover to 5.0% of general fund expenditures, but in 2022 they revised their projections, stating reserves would be 2.6%. Audited available reserves for fiscal 2022 are lower than projected at negative 1.8% due to a liability which officials did not expect to be reflected in the general fund.

We note the management team has seen turnover recently, with Anchorage now on its fourth CFO in four years, though we note the current CFO has been in his position for over a year and kept it through the recent mayoral transition that took place on July 1 2024. The municipality was late in producing its 2022 audit due to both a decline in staffing and an increase in required documentation and reporting requirements. While we expect that reserves will increase, with a history of worse-than-expected financial results, we anticipate reserves may not reach levels that the municipality is projecting.

The rating reflects our view of the municipality's:

- Broad and diverse economy, albeit with a declining population, which serves as Alaska's logistics, distribution, and tourism hub;
- Weak reserve position, with a still-negative available general fund balance that is expected to grow to positive levels in fiscal 2023, somewhat offset by very strong liquidity;
- We revised our view on management policies to standard from good, and note that the municipality has a leadership team in transition, including a new mayor, and we also note that Anchorage was unable to produce fiscal 2022 financial statements in a timely manner, but it has a strong institutional framework score; and
- Manageable debt burden with no additional debt plans in the next year, but relatively large pension and other postemployment benefit (OPEB) liabilities.

## **Environmental, social, and governance**

We view the municipality's recent turnover with a new mayor and management's inability to produce timely 2022 audited financial statements and likely delays in its 2023 audit as underscoring poor transparency and reporting practices and contributing to our view of the municipality's weaker financial management assessment. Furthermore, Anchorage's location near the Gulf of Alaska and together with temperature warming, could lead to melting permafrost and receding glaciers in the region, resulting in exposure to more frequent flooding and severe rainfall events. The area is also susceptible to earthquakes and avalanches, as evidenced by the 2021 avalanche on the north side of the municipality. Despite these exposures, Anchorage's maintenance of a hazard mitigation plan that outlines preparation

in cases of extreme weather somewhat offsets these risks. We also consider its gradual population decline as raising social capital risks over time, particularly if the trend leads to economic pressures, including affecting its property tax base.

## Outlook

Our stable outlook reflects our view that the municipality's reserves will reach positive levels in fiscal 2023 and will not materially decline through our outlook horizon.

### Downside scenario

We could take negative rating action if the municipality experiences further financial deterioration with draws on reserves, whether due to one-time capital needs or structural imbalance.

### Upside scenario

We could consider a positive rating action if Anchorage sustains positive budgetary performance for multiple years, indicating management's use of and communication about financial forecasting and proactive budget management.

## Credit Opinion

### Economy that anchors Alaska, with a slowly declining population

Anchorage serves as the economic center of Alaska; it has an economy with heavy tourism dependence and is a military and air logistics hub. The municipality has what we consider mostly indirect economic exposure to the ups and downs of the state's prominent oil and gas industry in the form of administrative and finance activities that serve Prudhoe Bay in the northeast corner of the state. Oil prices have recovered since the pandemic, and are currently near 80 dollars a barrel, from a low of just under 19 dollars a barrel in April 2020, which has provided some stability to the state budget. Officials note developments in oil-related projects on the North Slope are underway, which should support the local economy.

While a significant decline in tourism during the height of the pandemic led to a drop in hotel and motel revenue in 2020, we note it has since recovered, with a preliminary 2023 room tax collection of approximately \$44.8 million, higher than pre-pandemic levels. We expect the local economy will remain stable over the next few years due to the pickup in tourism despite the trend of slight population declines. We note there is no significant reversal to this trend in sight, and although higher oil prices generally attract additional workers to Alaska and bring in new residents, we don't expect material population growth in our outlook horizon. Assessed value has grown recently, with new construction spurring growth, especially in residential developments and in hotels, though we note construction of new buildings has slowed in 2024 compared to the prior year in terms of the number of permits issued for new construction.

### Reserves that declined materially due to COVID-19 expenditures and a 2018 earthquake, though recovery seems to be in progress

The municipality's financial position is a credit weakness, with negative available reserves in two consecutive audits. If its reserves do not improve as materially as officials expect in fiscal 2023, we could take further negative rating action, as the overall trend since 2018 has been downward. Fiscal 2021 resulted in a large deficit, mostly due to unplanned

expenditures and revenue loss. The COVID-19 pandemic had a negative effect on the tourism-heavy economy, causing a decline in hotel and motel revenue, along with an increase in expenditures including testing, shots, and housing. In addition, officials waited for a prolonged period to receive federal reimbursements after the 2018 earthquake. We believe the process for receiving the reimbursements took unusually long, which officials attribute partly to this being their first experience working with FEMA. Unexpected expenditures also arose in fiscal 2021, when an avalanche hit the north end of Anchorage.

The fiscal 2022 surplus mostly reflects expenditure savings, with notable vacancies in government positions, especially in police, and a lack of COVID-19-related expenditures compared to 2021. We note the municipality is significantly increasing police and fire salaries and benefits over the next few years, and most of its reserve improvement depends on FEMA reimbursements being reflected in its audits. While we anticipate reserves will likely increase with the fiscal 2023 audit, we do not yet have the 2023 financial statements and do not know the exact extent to which they will increase.

Our analysis of the municipality's general fund and total governmental fund results include our internal adjustments that remove property tax pass-throughs for its school district enterprise, one-time uses, and bond-related uses within the two funds. It also includes an adjustment for annual transfers from the MOA trust fund into the general fund. Our analysis of Anchorage's available general fund balance includes the portion classified as committed for its "bond rating"--a designation that leads us to view it as practically available if needed--maintained under a policy that calls for a minimum of 10% of expenditures, in addition to a 2%-3% emergency reserve. In addition, the municipality's reserves and performance are supported by the Municipality of Anchorage trust fund, which contributes a set percentage each year for operations. While the trust contains significant reserves (\$380 million as of Dec. 31, 2022), the charter governing the trust limits annual transfers to the general fund to 5%. Any change to the allocation of the trust over 5% annually must be approved by voters and at this time, officials do not plan on advocating for any changes to the formula. The Anchorage Municipal Code describes how the trust fund is managed and the assembly can make changes at any time.

### **Management with financial management policies and practices we consider adequate, with recent turnover and difficulty retaining staff**

The municipality has seen turnover in management positions the past few years, with particular difficulty in keeping the CFO position occupied. However, the current CFO has been with Anchorage since May 2023, and stayed in the position through the July 2024 mayoral transition. Due to the additional reporting requirements and a recent loss of staff in the accounting department (from a staff of 19 to six), Anchorage was late in producing its fiscal 2022 audit. In addition, it does not expect to issue the 2023 audited financial statements until late in 2024.

We consider the municipality's financial management policies and practices adequate, according to our financial management assessment, and these include:

- A budget process that involves extensive analysis of expenditure trends, major goals, and the economic outlook to validate assumptions;
- Monthly updates to the assembly (the municipality's legislative body) on budget-to-actual performance, though we note management has not made meaningful changes to its budget during times of distress midyear;

- Annually updated six-year projection model that informs management's budget recommendations and forward-looking analyses of trends affecting financial performance, although its details are not always included in the formal budget document and we do not believe it discusses in detail potential issues that could affect the municipality's financial position;
- Annually updated capital planning practice that addresses the timing and costs of capital projects, but also the implications for ongoing noncapital costs;
- Investment management under an internal policy and quarterly reporting to the assembly on performance and holdings;
- A formal comprehensive debt management policy that regulates issuance, type of debt issuance, and overall debt levels;
- Formal minimum reserve policy of 10% of expenditures to provide comfort to the credit markets and an additional 2%-3% reserve for emergencies, although the assembly just signed a resolution allowing an exception to handle COVID-19- and earthquake-related expenses; and
- We note measures have been taken to address cybersecurity, including a cybersecurity insurance policy.

### **Manageable debt, with no plans to issue GO debt in the next year**

The municipality's debt profile is adequate, but we believe it is manageable, with relatively affordable carrying charges and total overall net debt that is less than 3% of market value. Officials don't expect to issue additional GO debt in 2025, as the construction that the current debt issuance is funding will likely continue into next year. Therefore, we don't expect Anchorage's debt profile will deteriorate in our outlook horizon, though we note that depending on timing of revenue receipts, it may issue tax anticipation notes in the next year to provide temporary liquidity.

We also note the state has once again fully funded the municipality's school debt through a reimbursement program in fiscal 2023, and officials expect they will continue to be supported by the state.

### **Elevated pension costs, which could rise if the state decreases its contributions**

We consider the municipality's pension a source of potential credit pressure if the state reduces its contributions toward pension plans. Anchorage contributes 22% of employee salaries to the Alaskan Public Employees Retirement System (PERS), while the state funds the residual needed to fully fund the plans' actuarially determined costs. If the state lowers its contributions, we consider it likely that the municipalities' pension contributions will grow dramatically.

Anchorage participates in the following plans, with a total net pension liability for all plans of \$476.8 million.

- Alaska PERS, funded at 68.0%
- Police and Fire pension System, funded at 77.7%
- PERS Defined Contribution Plan
- Five OPEB plans in both PERS and the Police and Fire Retiree Medical Trust Plans (PFRMT),
- PERS Retiree medical plan and two PFRMT plans
- Two PERS plans, Alaska Retiree Healthcare Trust and Occupational Death and Disability

The municipality and its employees participate in three cost-sharing, multiple-employer plans provided by Alaska

PERS and boards associated with the municipality manage three small, closed plans. Like the municipality's income statement reporting, we understand that its pension contributions exclude those that the school district component unit makes to PERS. The pension plan features a 7.38% assumed rate of return, which indicates a significant exposure to market trends and conditions and which could cause the liability to fluctuate in the near term. With a closed layered 25-year amortization period, we believe the municipality will gradually make progress towards full funding, and we consider the closed layered amortization schedule conservative, which limits contribution volatility. However, the amortization period is a level-percent of payroll, which introduces risk of higher contributions, if not enough new entrants are hired to maintain the assumed payroll growth assumption of 2.75%. This is a risk given the declining population.

Anchorage, Alaska -- Key credit metrics				
	Most recent	Historical information		
		2022	2021	2020
<b>Very strong economy</b>				
Projected per capita EBI % of U.S.	112			
Market value per capita (\$)	137,809			
Population		287,383	286,633	
County unemployment rate(%)		3.3		
Market value (\$000)	39,564,690	36,237,162		
Ten largest taxpayers % of taxable value	3.1			
<b>Adequate budgetary performance</b>				
Operating fund result % of expenditures		7.7	(16.6)	7.0
Total governmental fund result % of expenditures		(1.0)	(3.9)	4.0
<b>Weak budgetary flexibility</b>				
Available reserves % of operating expenditures		(1.8)	(1.9)	6.4
Total available reserves (\$000)		(9,036)	(10,400)	27,556
<b>Very strong liquidity</b>				
Total government cash % of governmental fund expenditures		70	52	59
Total government cash % of governmental fund debt service		577	578	515
<b>Adequate management</b>				
Financial Management Assessment	Standard			
<b>Adequate debt &amp; long-term liabilities</b>				
Debt service % of governmental fund expenditures		12.1	9.0	11.4
Net direct debt % of governmental fund revenue	121			
Overall net debt % of market value	2.8			
Direct debt 10-year amortization (%)	58			
Required pension contribution % of governmental fund expenditures	5.5			
OPEB actual contribution % of governmental fund expenditures	0.4			
<b>Strong institutional framework</b>				

EBI--Effective buying income. OPEB--Other postemployment benefits.

## Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of July 19, 2024)		
Anchorage APPROP		
<i>Long Term Rating</i>	A+/Stable	Downgraded
Anchorage GO		
<i>Long Term Rating</i>	AA-/Stable	Downgraded
Anchorage GO		
<i>Long Term Rating</i>	AA-/Stable	Downgraded
Anchorage GO		
<i>Long Term Rating</i>	AA-/Stable	Downgraded
Anchorage GO		
<i>Long Term Rating</i>	AA-/Stable	Downgraded

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