Bond Case Briefs

Municipal Finance Law Since 1971

Fitch Ratings: Alaska Proposals to Limit Budget Flexibility Could Pressure Rating.

Fitch Ratings-New York-05 February 2019: Potential amendments to Alaska's constitution proposed by the governor last week would constrain the state's ability to proactively manage its financial operations and could result in negative pressure on the state's Long-Term 'AA' Issuer Default Rating (IDR)/Stable Outlook, according to Fitch Ratings.

The proposed amendments would require voter approval for new or increased taxes; enshrine the Permanent Fund (PF) dividend (PFD) formula, which is currently controlled by state statute, in the state constitution; place a more restrictive cap on annual growth in state expenditures; and prioritize the deposit of any fiscal year's unappropriated state general fund surplus to the PF ahead of the budget reserve fund, reducing funds available to cure any future budget shortfalls.

Fitch believes the enactment of these amendments, which require approval by two-thirds of each legislative chamber and a state-wide vote, could weaken assessments for key rating drivers related to budget control (i.e., independent legal ability to raise revenues, expenditure flexibility, financial resilience, and budget management), and therefore, exert pressure on the 'AA' IDR for the state. Removing legislative discretion over the PFD formula alone would require a $1.9 billion dividend payment to residents in fiscal 2020, well ahead of the $1.2 billion payment proposed by the prior governor in his $6.9 billion executive general fund budget. Barring other offsetting action, this would result in a more significant draw on the approximate $16 billion PF Earnings Reserve (PFER) than currently expected. The maintenance of reserves is a significant rating consideration for Alaska given the volatility inherent in the economic and resource base (see "Fitch: Depletion of Alaska's PF Earnings Reserve a Possibility" dated July 2, 2018).

Separate legislation submitted on behalf of the governor seeks to appropriate additional funds from the PFER over the next several years to retroactively restore residents' full dividend payments pursuant to the dividend formula; this amount has been reduced in each of the last three fiscal years as part of the state's budget balancing measures. Passage would result in larger PFD payments from the PFER for eligible residents in fiscal years 2020 through 2022. The state estimates restoration payments would total a maximum of $2.3 billion based on proposed eligibility guidelines.

Under the PF Protection Act of 2018, the state established annual draws on the PFER as a means for addressing ongoing projected budget gaps. Fitch's analysis at that time determined that eventual depletion of the PFER was likely in the long term, and noted that prudently structured draws would be necessary to sustain the assets. Enactment of the proposed measures would be expected to escalate depletion of the PFER, barring other moves to reduce the anticipated use of PFER funds to support general operations.

Governor Dunleavy's fiscal 2020 budget proposal is expected to be presented to the legislature on February 13 for their consideration. The governor has publicly committed his administration to delivering a balanced budget without the use of budget reserve funds. In the context of crude oil prices that are forecast at $64/barrel, as compared to much higher historical averages, there is the potential for significant spending cuts. Fitch will evaluate the details of the budget once it is available with an eye toward the critical drivers that have sustained the state's 'AA' IDR: substantial independent management power over revenue raising and expenditure decisions and maintenance of sizable reserves to offset volatility in key revenue sources.

Contact:

Marcy Block
Senior Director
+1-212-908-0239
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Douglas Offerman
Senior Director
+1-212-908-0889

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com