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Fitch Ratings: Alaska Governor's Budget Proposals Would Weaken Municipal Credit Quality

Fitch Ratings-San Francisco-22 February 2019: Fitch Ratings believes the governor of Alaska's fiscal 2020 budget proposals that affect local governments and alter municipal property tax laws could have significant negative impacts on the credit quality of local municipalities throughout the state if enacted. Fitch does not anticipate immediate rating changes due to the legislation because prospects for passage are uncertain. Fitch will monitor progress of the legislation and may take rating action if passage begins to appear more definite.

The budget proposal eliminates the state's school bond debt reimbursement program for local governments and cut unrestricted general fund spending for schools by 24%. A second, related proposal would shift property tax levies on oil and gas infrastructure from the local level to the state.

While Alaska's schools are governed by school boards, boroughs levy property taxes on their behalf, and boroughs and school districts share operating tax caps. Fitch believes enacted reductions in state formulaic school funding could pressure borough policymakers to backfill some district revenue losses, creating budget stress for borough governments and potentially crowding out other services.

The loss of school bond reimbursement would prompt immediate increases in debt service property tax rates that support schools' unlimited tax general obligation (GO) bonds. Higher debt service tax rates could make it more difficult to offset operating revenue losses even for jurisdictions that are not at their tax caps and could decrease public appetite for school bonds to meet ongoing capital needs.

The change in taxation of oil infrastructure would be of particular concern for the North Slope Borough ('AA'/Stable), which relies almost entirely on an energy-dominated property tax levy. The North Slope Borough collects about 85% of the $440 million in revenue that could be shifted to the state from local governments under the proposal. North Slope's estimated revenue is about $372.1 million, or 93% of its 2018 property tax revenues and 86% of total general fund revenues, with the exact loss dependent on which assets are classified as oil infrastructure.

The vast and sparsely populated borough covers the state's Arctic coast and Prudhoe Bay oil fields. Outside of the energy sector, the borough's small, remote communities have very limited tax bases and economies. Fitch believes the borough is unlikely to be able to reduce spending to match revenues available under the governor's plan, and earnings on its large permanent fund (which had a corpus of $708 million at the end of fiscal 2018) would be insufficient to replace the lost revenues on an ongoing basis.

The borough's rating incorporates the narrow, highly concentrated tax base as an asymmetric risk factor. However, the rating does not incorporate the risk of a sudden change in state tax law of the sort proposed by the governor. The borough had about $162.7 million of GO bonds outstanding at the end of fiscal 2018 and keeps debt maturities very short.

The impact of the change in the property tax regime would be notable but much less dire for other local governments in the state. For instance, the Fairbanks North Star Borough (IDR ‘AA’/Stable), which has the second-highest exposure among rated entities, collected about $11.2 million in oil infrastructure property taxes in fiscal 2018, approximately 10% of its overall general fund revenue. Anchorage, the state’s largest city, has a much more diverse tax base with less than 0.5% of revenues derived from property taxes on energy infrastructure.

The governor has also proposed amendments to the state’s constitution in support of his initiatives. For details, see “Fitch Ratings: Alaska Proposals to Limit Budget Flexibility Could Pressure Rating”, published Feb. 5, 2019.

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