

## **FITCH RATES MATANUSKA-SUSITNA BOROUGH, AK 2016A GO BONDS 'AA'; OUTLOOK STABLE**

Fitch Ratings-San Francisco-26 September 2016: Fitch Ratings has assigned a 'AA' rating to the following Matanuska-Susitna Borough, Alaska (the borough) bonds:

--Approximately \$30 million general obligation (GO) refunding bonds series 2016A.

In addition, Fitch has affirmed the following ratings at 'AA':

--Issuer Default Rating (IDR);

--\$316.4 million outstanding GO bonds.

The Rating Outlook is Stable.

The 2016A bonds are scheduled to sell via negotiation on or about Oct. 6, 2016. The borough will use the proceeds to refund its outstanding 2009A and 2011A GO bonds for savings and to pay costs of issuance.

### **SECURITY**

The GO bonds are payable from an unlimited ad valorem property tax levied against all taxable property within the borough.

### **KEY RATING DRIVERS**

The 'AA' ratings reflect very strong financial performance, superior inherent budget flexibility (solid control of both revenues and expenses) and low liability burden. The rating also reflects credit risk associated with the remote and still developing nature of the borough's economic base and the weakness of Alaska's economy more broadly.

#### **Economic Resource Base**

Matanuska-Susitna Borough is the second most populous municipality in the state of Alaska with slightly over 100,000 residents. The borough serves as a bedroom community for Anchorage and has been the state's fastest growing community in recent years. The economic resource base remains narrower and more isolated than the average U.S. local economy but features solid incomes and growing healthcare, retail, construction and governmental sectors supplementing historical strengths in tourism and agricultural. The borough is not an oil production center, but recent weakness in the Alaska's energy economy represents a risk to its rapid growth profile.

#### **Revenue Framework: 'aa' factor assessment**

Historical revenue growth has been exceptionally strong, outpacing U.S. inflation and economic expansion by a wide margin. Revenue growth is likely to be more muted in the intermediate term due to cuts in state aid and overall weakness in the state's economy, but Fitch believes longer-term trends will likely exceed inflation. Revenue raising flexibility relative to its revenue volatility is high with property tax rates at less than half the statutory cap.

#### **Expenditure Framework: 'aa' factor assessment**

Expenditure growth tracks population and tax base gains well and is therefore expected to track the borough's revenue gains. Expenditure flexibility is solid with a low fixed cost burden, a manageable labor relations framework and ample ability to adjust service levels. The borough is

facing a period of spending pressures due to state cuts to education funding, creating pressure on local governments to backfill state cuts.

#### Long-Term Liability Burden: 'aaa' factor assessment

Fitch expects the borough's long-term liability burden to remain on the high end of the 'aaa' factor assessment. The metric is largely driven by direct debt of the borough (which includes school district debt) and is repaid at a rapid pace. Issuance plans are moderate.

#### Operating Performance: 'aaa' factor assessment

Financial resilience is exceptional with very high reserves and generally positive margins providing a solid buffer against typical cyclical revenue variations. Budget management in times of recovery is strong with conservative budget management and consistent efforts to maintain structural budget balance.

### RATING SENSITIVITIES

**ECONOMY LIMITS RATING:** The rating is sensitive to changes in Matanuska-Susitna Borough's economic profile, revenue performance and budget management practices. The Stable Outlook means Fitch does not expect such changes. The rating is unlikely to move higher until the economic base grows and diversifies further.

### CREDIT PROFILE

The borough's population has more than doubled over the past two decades as workers and families sought more affordable homes and larger yards in the rural, historically agricultural area outside of Anchorage, the state's economic center. Communities in the southern part of the borough - including Wasilla, Palmer and Houston - are within commuting distance of Anchorage and are increasingly suburban in character with subdivision development, big box retail stores, a modern hospital and a growing service economy.

The borough's economy is less directly exposed to the state's struggling energy sector than many other areas of the state. The borough is not an oil production center, and oil companies are not among its top taxpayers or employers. More than 55% of borough's workforce is now employed within the borough in an increasingly diverse service economy. About 30% commute to Anchorage, and fewer than 10% commute to the North Slope to work in the oil fields. However, Fitch believes the borough remains somewhat exposed due to the oil industry's outsized influence on the state economy, which drives both state government employment and spending levels within the borough, and by the industry's impact on Anchorage metropolitan area. Anchorage serves as the headquarters city for oil and oilfield services companies, as well as the large professional and the business services industry that serves the energy companies. Fitch believes Matanuska-Susitna Borough is unlikely to sustain rapid growth at times of weakness in the Anchorage and overall Alaska economies.

Borough economic indicators have weakened somewhat in the two years since oil prices entered the current period of extreme weakness. The borough's non-seasonally adjusted unemployment rate trends higher than the national rate and averaged about 8.1% over the 12 months ending July 2016. The jobless rate is running about a half percentage point higher than year-ago levels so far this year. The borough's taxable assessed value continues to grow, increasing 3.5% in 2015 and 2.9% in 2016 to a record high of \$9.3 billion, but growth is well below earlier levels. The tax base is diverse and largely residential with no concentration among top taxpayers or economic sectors.

Economic considerations have weighed less on the rating over time with growth and broadening of the economic resource base, but the borough remains an outlier in terms of remoteness and the narrowness of the economy. The borough is actively working to further expand economic

activity through development of a deep-water bulk cargo port, continued expansion of its residential housing base and expansion of its tourism infrastructure. The borough is home to tourist destinations such as to Denali State Park, Talkeena (jumping off point for Denali mountain climbers), the Matanuska Glacier and Hatcher Pass (site of development plans for a ski resort). Port development is moving forward slowly with a short-term goal of connecting the port to existing rail lines and a long-term goal of spurring commodity extraction enterprises in the borough and throughout the Alaska interior. Continued development of the economy could eventually lead to further upward movement in the rating, but such development is a gradual process that is likely to take many years.

#### Revenue Framework

The borough's revenue framework is dominated by very stable property tax revenues, which provide about 60% of general fund revenues. Intergovernmental revenues (including state revenue sharing and debt service reimbursements) account for 28% of 2015 revenues.

Revenue growth has been very strong but is likely to weaken in the near-term due to weakness in state revenues and the broader economy. Total general fund revenues increased at a compound annual growth rate of 7.1% over the past decade, exceeding U.S. GDP growth. Revenue growth is largely driven by population gains and expansion in taxable assessed values, but Fitch believes those trends are at risk of weakening so long as the state's economy remains weak. The state of Alaska's economy suffers from heavy reliance on the energy extraction sector, which is in decline due to both low oil prices and declining production in mature oil fields.

The elected borough Assembly has a high degree of independent revenue raising flexibility. The borough's area-wide property tax rates are about a third of the maximum allowed under state law at just less than 10 mills. The legally allowable tax increase is many times the level of the revenue loss Fitch believes the borough may experience in a moderate U.S. economic downturn.

#### Expenditure Framework

The borough's spending obligations are quite limited relative to other local governments in the U.S. with a strong local policymaking consensus in favor of limited government. The borough's spending primarily supports schools, as well as road and other local infrastructure investments. Educational expenditures accounted for slightly over half of fiscal 2015 expenditures and largely reflect a pass-through of property taxes levied on behalf of the school district. The borough also provides local library, ambulance, fire, and parks and recreation services. Police and criminal justice services are provided by the state or local cities.

Spending growth tracks increases in the population and increases in revenues well. The main current expenditure pressure is education with local policymakers under pressure to make up for school funding cuts with local tax revenues. The state has cut both per pupil funding and debt service support for school bonds. Fitch expects spending growth to generally fall below the level of revenue growth on average over time despite current spending pressures.

Expenditure flexibility is solid. Fixed carrying costs for debt, pensions and other post-employment benefits equaled a very low 5.6% of spending in fiscal 2015. The labor negotiating framework is manageable with management retaining strong control over headcount and compensation levels. The borough Assembly may impose terms after following a structured bargaining process that includes mediation and fact-finding to resolve impasses. In practice, the borough has enjoyed constructive relations with its workers and has been able to secure concessions to control compensation costs during the current downturn. Management believes its primary areas of spending flexibility are capital spending and headcount control. About two thirds of workers are temporary or seasonal employees, allowing management to make meaningful adjustments to compensation costs before resorting to layoffs of full-time employees. The borough also has some discretion over the level of school funding above the state required minimum effort.

## Long-Term Liability Burden

The long-term liability burden is low relative to the economic resource base at 7.7% of personal income. The borough issues bonds for both its own purposes and for the component unit school district, and the few incorporated cities in the area are very sparing users of debt, limiting overlapping debt. The direct debt burden is dominated by fully amortizing GO bonds with a solid amortization rate (greater than 60% of bonds repaid in 10 years). Issuance plans are moderate and not expected to increase the ratio of debt to personal income over the next several years. Unfunded pension liabilities are low at about \$29 million, or 0.5% of personal income, assuming Fitch's standard 7% rate of return assumption.

## Operating Performance

The borough is well positioned to withstand typical cyclical stresses with very high reserves relative to its revenue volatility. Fitch expects the borough to maintain a reserve safety margin that is well above the level Fitch believes is necessary to offset revenue volatility by using its superior inherent budget flexibility to maintain compliance with strong minimum fund balance policies. Fitch's standard 1% decline in U.S. GDP stress scenario suggests the district may experience a general fund revenue decline of 2.4% in a moderate economic downturn, according to the Fitch Analytical Sensitivity Tool (FAST). Inherent budget flexibility is judged to be superior because the borough has both strong expenditure flexibility and a high degree of revenue raising flexibility under its state tax cap. Fitch believes the borough is likely to resolve budget imbalances largely through use of expenditure reductions and gradual spending of excess reserves above its fund balance policy. The borough is unlikely to rely heavily on its tax raising flexibility due to local policymaker preferences for low property tax rates.

The borough's fiscal 2015 unrestricted fund balance was very strong at \$57.9 million, or 41.5% of expenditures and transfers out. Fitch expects moderate draws on fund balance as the borough manages the current period of economic weakness, but does not expect fund balance to fall to a level that would pressure the operating performance attribute assessment or the rating.

Budget management in times of recovery is strong due to conservative budgeting practices that lead to rapid rebuilding of financial flexibility after periods of reserve spending. The borough consistently works to maintain budget balance by adjusting the trajectory of spending rather than relying on deferrals or one-time gap closing measures during typical budget years.

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In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

## Applicable Criteria

U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)

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