



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Revenue

TREASURY DIVISION

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Memorandum

TO: Sheldon Fisher, Commissioner, Department of Revenue
FROM: *Deven Mitchell*
Deven Mitchell, Debt Manager, Treasury Division
DATE: April 16, 2018

SUBJECT: Debt potentially impacted by broad interpretation of "debt" in Alaska Constitution

You have asked me to summarize existing Alaska debt that could be called into question if the Alaska Courts adopted a broad interpretation of the word "debt" as the term is used in the Alaska Constitution, art IX, sections 8 and 11.

By way of background, during my involvement in State of Alaska debt issuances since 1997, the Department of Revenue, Treasury Division and the Alaska courts have narrowly interpreted the word "debt" as it is used in the Alaska Constitution. Constitutional debt is only debt that pledges the full faith and credit of the state. Such constitutional debt essentially gives the courts the power to appropriate debt service if there is a default by the legislature in appropriating debt service.

In reliance on advice from the Department of Law as well as external bond counsel firms, and their reading of case law from Alaska and other states, the State has issued a variety of debt that does not fall within the narrow description of debt under the Alaska Constitution. These are debt types that do not pledge the full faith and credit of the state, and therefore do not require a vote of the people. Neither do these debt types provide authority to a court to compel payment of debt service. Accordingly, these debt types are governed by neither section 8 nor section 11 of article 9, Alaska Constitution.

A broad reading of the constitution -- in other words an interpretation of "debt" to include all debt, whether or not it confers the power of appropriation on the courts to compel debt service -- would be highly disruptive, and would likely invalidate multiple forms of existing debt in Alaska.

The State has \$237 million of outstanding Subject to Appropriation bonds secured only by an annual appropriation commitment of the State. They are:

- Matanuska-Susitna Lease Revenue Bonds to Fund the Goose Creek Correctional Facility
- State of Alaska's Certificates of Participation issuance to fund the Alaska Native Tribal Health Consortium's Residential Housing Facility

An additional State bond issuer that may be impacted by a broad interpretation of constitutional debt is the University of Alaska. As the University relies on the State for three quarters of its revenue (through general fund appropriations for operations and debt service as well as tuition scholarships flowing from the State), this interpretation might limit the University's bond issuance program security to those revenues derived from sources other than the State. The University currently has \$311 million of debt outstanding that may well be downgraded several credit ratings and the University could lose access to the municipal market with this interpretation.

Another authorized, but unissued Subject to Appropriation obligation is an amount of \$300 million for the Knik Arm Crossing. This is described as revenue debt, but was to be backed by a Subject to Appropriation pledge of the State with the knowledge that toll revenue would be deficient for some period of time and the only payments for debt service would be coming from the State's general fund.

We understand concern has been expressed regarding the marketability of Subject to Appropriation debt. This concern is misplaced. In the municipal bond market, Subject to Appropriation obligations are typically rated 1 credit notch off of the credit that has authorized and supports them. In short, Subject to Appropriations bonds carry specific rating criteria in the Municipal Bond market, are a well understood and commonly used financing tool, and will be highly rated based on the State of Alaska's credit.

Finally, if the broad view of constitutional "debt" is adopted, the State would likely be unable to issue pension obligation bonds as currently authorized. We note that the issuance of these bonds have been approved in many locations throughout the country, and that two nationally recognized bond counsel firms have determined that the pension obligation bond structure in Alaska is permissible under Alaska law.

The State's position with respect to HB 331/SB 176 is that the proposed obligation is a commitment recognized by and commonly used within the municipal bond market as a "Subject to Appropriation" obligation. Subject to Appropriation obligations are not considered debt for constitutional purposes as any legislature can choose not to appropriate. While there are negative ramifications for not appropriating such as State credit downgrades and loss of access to capital markets, there are negative ramifications for a wide array of annual appropriations. For example, if the state does not appropriate for other core financial obligations such as pension funding, public safety, or required industry oversight it would similarly be facing negative credit rating action.

Also, please note that the intention of using a public corporation to issue bonds with HB 331/SB 176 was not to fall into the exception clause in the Alaska Constitution, Art. IX, Section 11. Initially the Department proposed having the State Bond Committee issue the subject to appropriation bonds, but instead decided to follow the existing Alaska Pension Obligation Bond Corporation model.