



## State of Alaska

# Update on the State's Rainy Day Funds and Discussion of State Cash Flows

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January 30, 2020 House Finance presentation

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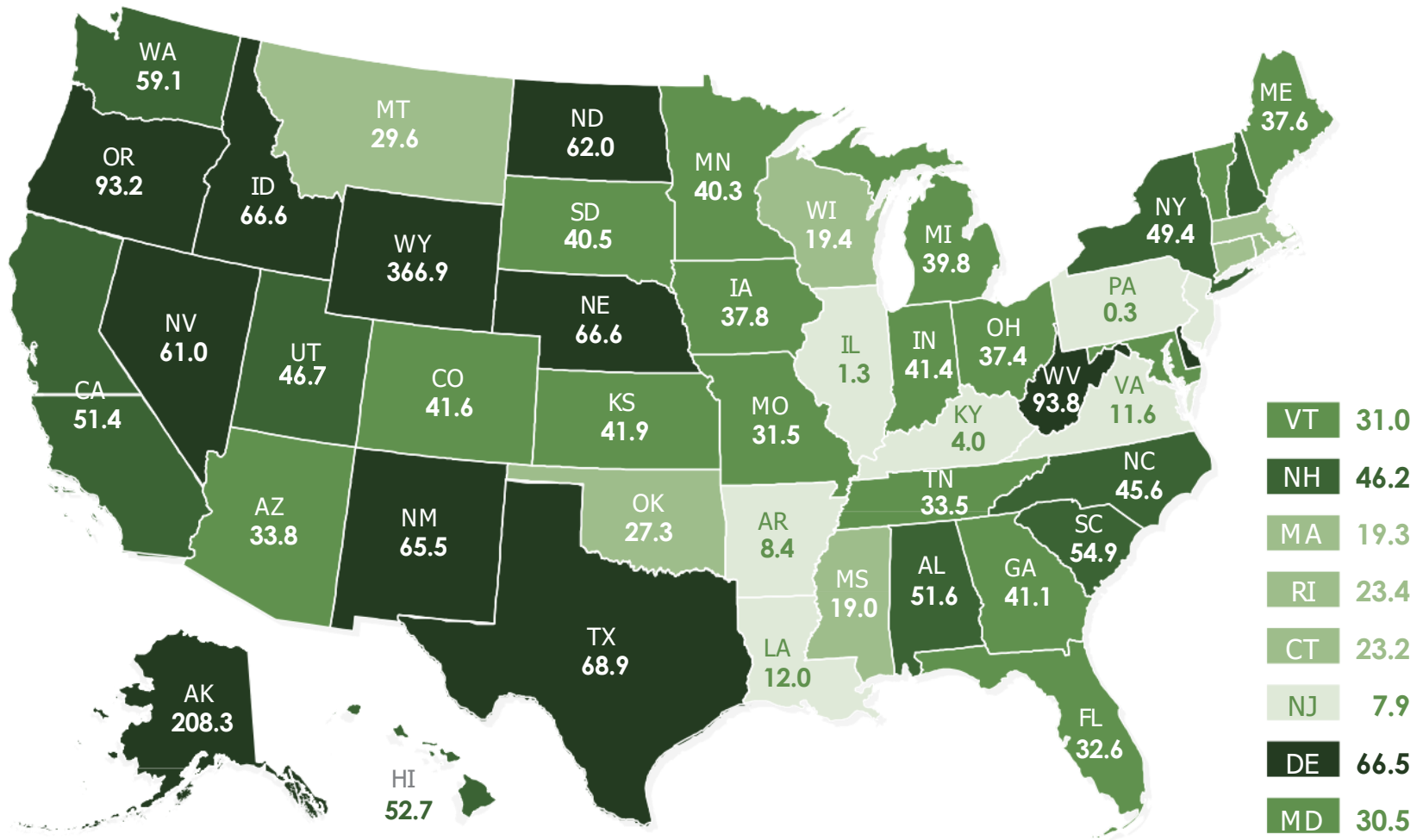
# **Update on Rainy Day and Other Funds**

## FY21 Days that Alaska could run on Total Balances (Rainy Day and Other Funds)

	FY21 Estimated Beg Balance (billions)	FY21 \$4.5B Budget Coverage (ex PFD)
<b>Alaska's Funds</b>		
Traditional Rainy Day Fund:		
➤ <b>Constitutional Budget Reserve Fund (CBRF)</b>	\$1.9	154 days
Other Large Funds that could be turned to when CBRF is exhausted:		
➤ <b>Power Cost Equalization Fund</b>	\$1.1	89 days
➤ <b>Alaska Higher Education Investment Fund</b>	\$0.4	32 days
Other Designated Funds (Subfunds of the General Fund) (e.g. AMHS Vessel Replacement, Major Maintenance Grant, Community Assistance, Alaska Capital Income, Highway Equipment Working Capital)	\$0.4 Minimum	32 days
<b>Total Funds Available before unstructured draw from ERA</b>	\$3.8	307 days
Earnings Reserve Account (uncommitted at 12/31/19)*	\$10.2	827 days
<b>Total with ERA</b>	\$14.0	1,134 days

\*Source: apfc.org

# Days Each State Could Run on Total Balances in FY 2018



**40.4** 50-state median

0 to 15 days    15 to 30 days    30 to 45 days    45 to 60 days    More than 60 days

Source: Pew analysis of data from the National Association of State Budget Officers

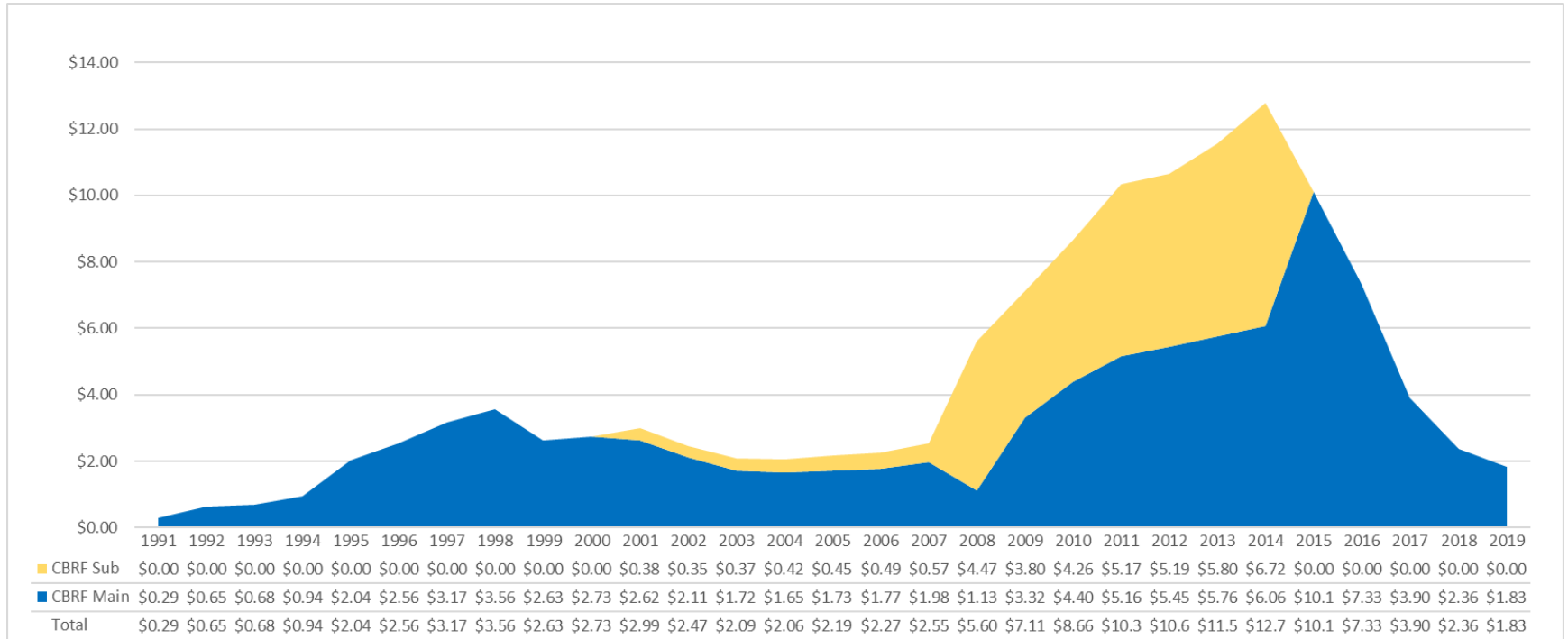
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# Constitutional Budget Reserve Fund

- In 1990, voters of Alaska adopted an amendment to the constitution creating the CBRF. The fund was established as a savings fund to enhance budget stability. Consists of deposits resulting from resolutions of disputes about the amount of mineral lease bonuses, royalties or taxes.
  - Legislature may appropriate from the CBRF to fund operations under certain conditions:
    - Simple majority vote if available funds from other sources are less than amount appropriated to fund state government for the previous fiscal year.
    - Otherwise 3/4s vote.
  - Borrowings are allowed to fund temporary cash deficiencies and budget shortfalls as appropriated by the legislature.
  - Borrowings must be repaid to the CBRF when there is a surplus in the general fund at the end of the year.
  - As of FY10, the CBRF was repaid and no borrowing occurred FY 11-FY14.
  - A Sub-fund of the CBRF was established in 2000. In 2008, \$4.1 B was deposited (1.5 CBRF Main + \$2.6B from GF). Sub Fund was liquidated in 2015 as required by statute as funds were deemed to be needed with 5 years.
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# Constitutional Budget Reserve Fund Historical Invested Assets (in billions)



Data is at fiscal year end of June 30.

# Constitutional Budget Reserve Fund

Fiduciary oversight: Commissioner of Revenue

		<b>Constitutional Budget Reserve</b>	
<b>Investment Objective</b>		Moderate Risk, Intermediate investment horizon	
<b>Target Asset Allocation</b>		<p>A 3D pie chart illustrating the target asset allocation for the Constitutional Budget Reserve Fund. The largest slice is Cash Equivalents at 75%, followed by Broad Fixed Income at 21%, Global Ex-US Equities at 2%, and Broad Domestic Equities at 2%.</p>	
<b>Market Value (\$thousands)</b>	12/31/2016	Actuals	
	12/31/2017	<b>\$5,670,300</b>	
	12/31/2018	<b>\$3,087,000</b>	
	12/31/2019	<b>\$1,710,500</b>	
<b>Returns 12/31/2019 (Rolling)</b>	3 Month	Actuals	Benchmark <sup>1</sup>
	6 Month	0.78%	0.74%
	1 Year Actuals	1.72%	1.67%
	3 Year Actuals	5.48%	5.34%
	3 Year Actuals	3.04%	2.91%
	5 Year Actuals	2.28%	2.06%
<b>Callan Projected 10-Year Return: 3.01%</b>			

<sup>1</sup>Cash Equivalents: 3-month U.S. Treasury Bill; Broad Fixed Income: Barclays U.S. Aggregate Index; Broad Domestic Equities: Russell 3000 Stock Index; Global ex-US Equities: MSCI ACWI ex-US Index

Current Fiscal Year market values and stated returns are unaudited, preliminary, and include some estimates.

# Power Cost Equalization

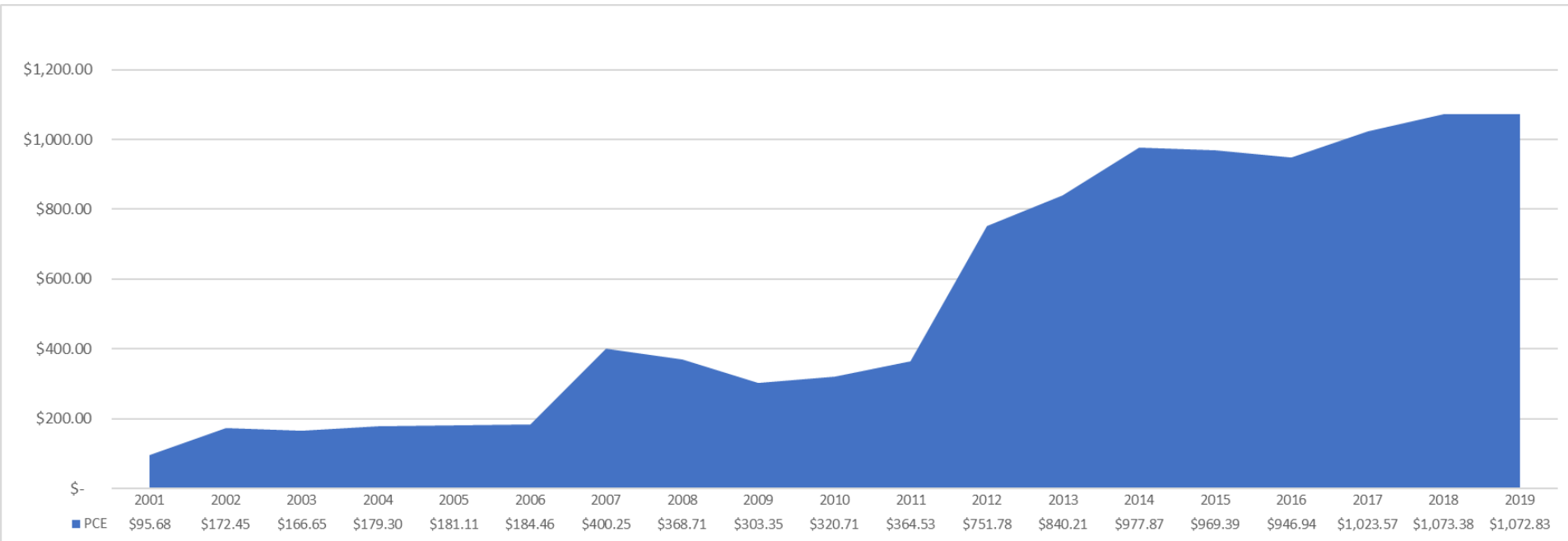
- The purpose of the PCE Endowment fund is to provide for a long-term stable financing source that provides affordable levels of electric utility costs in otherwise high-cost service areas of the state.
- 5% of the monthly average market value of the fund for the previous 3 fiscal years may be appropriated. If prior years earnings exceed this amount, 70% (not to exceed \$55M) of the difference can be spent on related identified programs. Commerce is the agency that oversees the spending of the fund. SB196, effective 6/30/2016, changed the spending target from 7% to 5%.

## *Fund History:*

- 2000-Power Cost Equalization Endowment Fund established from Constitutional Budget Reserve  
Appropriation of \$100 million
- 2002-PCE receives \$89.6 million from proceeds of the sale of the four dam pool hydroelectric project.
- 2007-Additional appropriation of \$182.7 million
- 2012-Additional appropriation of \$400 million



# Power Cost Equalization Historical Invested Assets (in millions)



Data is at fiscal year end of June 30.

# Power Cost Equalization Fund

Fiduciary oversight: Commissioner of Revenue

		Power Cost Equalization Fund	
<b>Investment Objective</b>		High Risk, Long Term investment horizon	
<b>Target Asset Allocation</b>		<p>A 3D pie chart illustrating the target asset allocation for the Power Cost Equalization Fund. The chart is divided into three segments: Broad Domestic Equities at 41% (the largest segment, in a medium blue), Broad Fixed Income at 32% (the smallest segment, in a light blue), and Global Ex-US Equities at 27% (the middle segment, in a dark blue). The chart is shown from an isometric perspective, giving it depth.</p>	
<b>Market Value (\$thousands)</b>	12/31/2016	Actuals	
	12/31/2017	<b>\$947,300</b>	
	12/31/2018	<b>\$1,088,800</b>	
	12/31/2019	<b>\$959,800</b>	
<b>Returns 12/31/19 (Rolling)</b>		Actuals	Benchmark <sup>1</sup>
	3 Month	6.09%	6.15%
	6 Month	7.05%	7.05%
	1 Year Actuals	21.67%	21.71%
	3 Year Actuals	10.03%	10.11%
5 Year Actuals	7.48%	7.30%	
<b>Callan Projected 10-Year Return: 6.58%</b>			

<sup>1</sup>Broad Fixed Income: Barclays U.S. Aggregate Index; Broad Domestic Equities: Russell 3000 Stock Index; Global ex-US Equities: MSCI ACWI ex-US Index

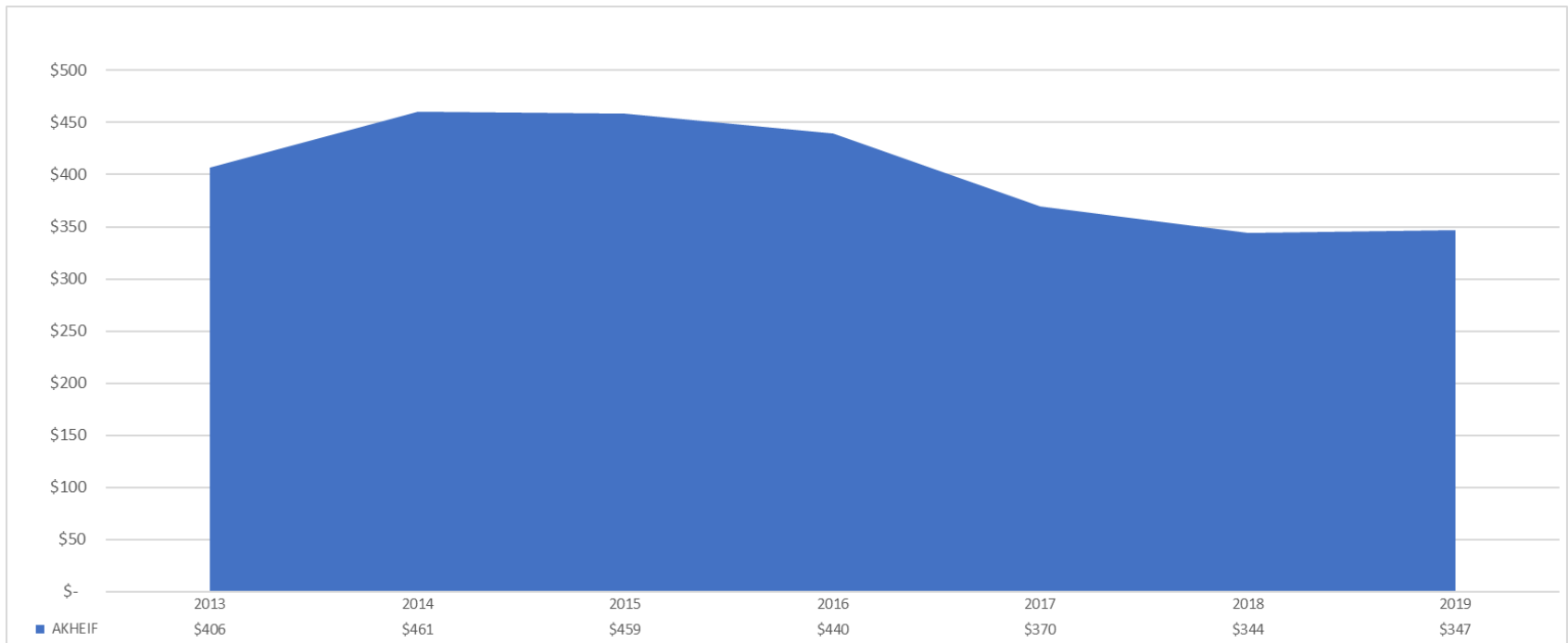
Current Fiscal Year market values and stated returns are unaudited, preliminary, and include some estimates. Asset Allocation does not include private investments.

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# Alaska Higher Education Investment Fund

- On September 1, 2012, the Alaska Higher Education Investment Fund was capitalized with a \$400 million deposit from receipts of the Alaska Housing Capital Corporation.
- On January 28, 2013 the Alaska Higher Education Investment Fund was moved out of the General Fund into a segregated fund, and an asset allocation was approved to generate earnings sufficient to meet the seven percent annual appropriation amount as required by AS 37.14.750.(c).
- Two-thirds of each year's appropriation is allocated for Alaska Performance Scholarship Awards and one-third of the appropriation be allocated for AlaskAdvantage Education Grants.
- In FY2019, \$11.75 million was allocated for Alaska Performance Scholarship Awards, and \$5.875 million was allocated for AlaskAdvantage Education Grants.
- In FY2020, \$11.75 million was allocated for Alaska Performance Scholarship Awards, and \$5.842 million was allocated for AlaskAdvantage Education Grants.

# Alaska Higher Education Investment Fund Historical Invested Assets (in millions)



*Data is at fiscal year end of June 30.*

# Alaska Higher Education Investment Fund

Fiduciary oversight: Commissioner of Revenue

		AK Higher Education Investment Fund	
<b>Investment Objective</b>		High Risk, Long Term investment horizon	
<b>Target Asset Allocation</b>		<p>A 3D pie chart illustrating the target asset allocation for the AK Higher Education Investment Fund. The chart is divided into three segments: Broad Domestic Equities at 41% (the largest segment, colored in a medium blue), Broad Fixed Income at 32% (colored in a light blue), and Global Ex-US Equities at 27% (colored in a darker blue). The chart is shown from an angled perspective, giving it depth.</p>	
<b>Market Value (\$thousands)</b>	12/31/2016	Actuals	
	12/31/2017	\$351,500	
	12/31/2018	\$353,400	
	12/31/2019	\$313,400	
<b>Returns 12/31/2019 (Rolling)</b>		Actuals	Benchmark <sup>1</sup>
	3 Month	6.09%	6.15%
	6 Month	7.05%	7.05%
	1 Year	21.71%	21.71%
	3 Year	10.08%	10.11%
	5 Year	7.44%	7.33%
<b>Callan Projected 10-Year Return: 6.58%</b>			

<sup>1</sup>Broad Fixed Income: Barclays U.S. Aggregate Index; Broad Domestic Equities: Russell 3000 Stock Index; Global ex-US Equities: MSCI ACWI ex-US Index

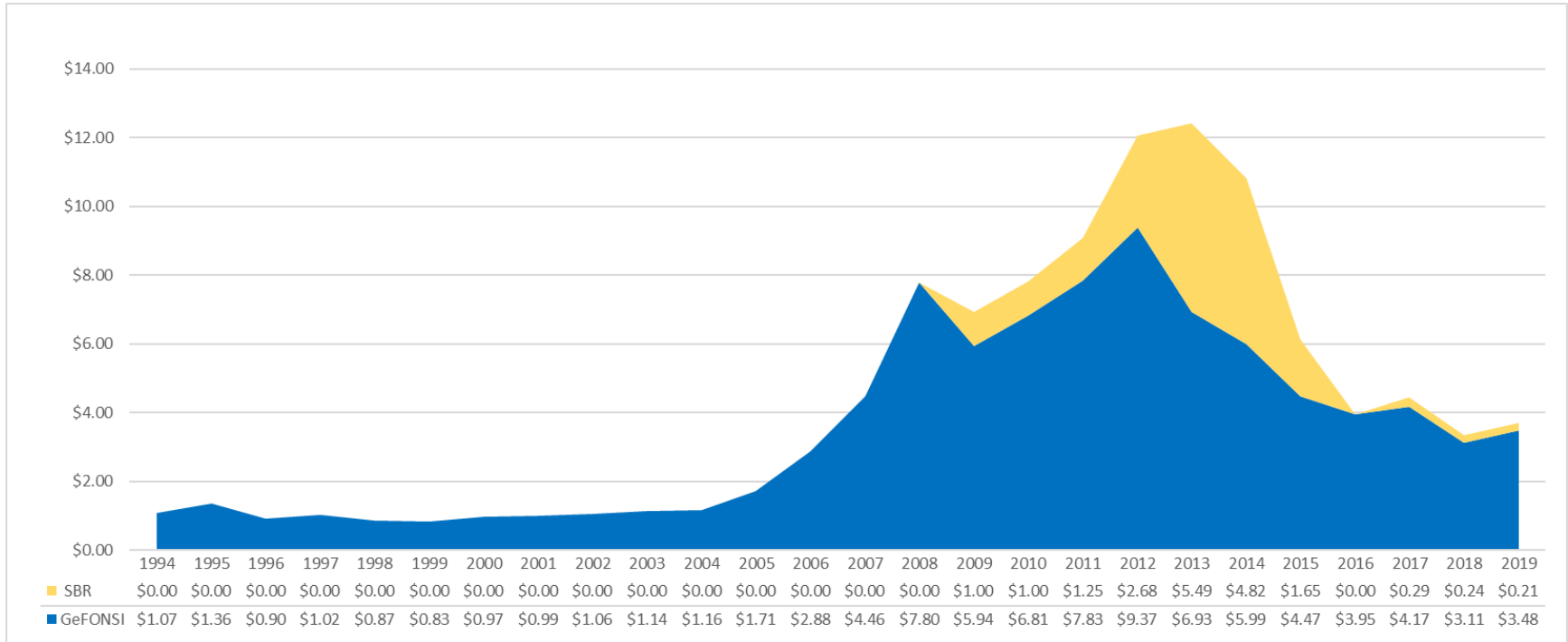
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# GeFONSI I and II

- GeFONSI includes the General Fund and Other Non segregated funds invested in a pooled environment (GF proper= \$400 million).
- Department of Administration separately accounts for each fund within State Accounting system.
- Department of Revenue is responsible for investing the GeFONSI and calculating and allocating daily investment earnings to each fund.
- 185 funds, assigned as Types 1, 2, or 3. Type 1 funds receive their earnings, the others do not.
- GeFONSI II was created in 2018 to target a higher risk return profile and includes funds that are type 2 or 3.

# General Fund and other non-segregated investments Historical Invested Assets (in billions)\*



\* The Statutory Budget Reserve Fund (AS 37.05.540) was part of the GeFONSI before and after being managed as a separate fund from July, 2013-October, 2015.

# General Fund and other non-segregated investments (GeFONSI I & II)

Fiduciary oversight: Commissioner of Revenue

		GeFONSI I		GeFONSI II	
<b>Investment Objective</b>		Moderate Risk, Short to Intermediate investment horizon		Moderately High Risk, Intermediate investment horizon	
<b>Target Asset Allocation</b>		<p>1-3 Year Gov't Bonds, 17%</p> <p>Cash Equivalents, 83%</p>		<p>1-3 Year Gov't Bonds, 31%</p> <p>Broad Domestic Equities, 4%</p> <p>Global Ex-US Equities, 3%</p> <p>Broad Fixed Income, 9%</p> <p>Cash Equivalents, 53%</p>	
<b>Market Value (\$thousands)</b>	12/31/2016	Actuals		Actuals*	
	12/31/2017	\$3,375,800		N/A	
	12/31/2018	\$3,340,000		N/A	
	12/31/2019	\$1,822,900		\$1,429,900	
	Combined @ 12/31/2019	\$1,389,000		\$1,223,600	
		<b>\$2,612,600</b>			
<b>Returns 12/31/19 (Rolling)</b>		Actuals	Benchmark <sup>1</sup>	Actuals	Benchmark <sup>1</sup>
	3 Month	0.49%	0.47%	1.07%	1.04%
	6 Month	1.07%	0.98%	1.77%	1.63%
	1 Year Actuals	2.90%	2.68%	6.38%	6.25%
	3 Year Actuals	1.90%	1.72%	N/A	N/A
	5 Year Actuals	1.38%	1.16%	N/A	N/A
		<b>Callan Projected 10-Year Return: 2.65%</b>		<b>Callan Projected 10-Year Return: 3.30%</b>	

<sup>1</sup>Cash Equivalents: 3-month U.S. Treasury Bill; 1-3 Year Government Bonds: Barclays 1-3 Year Gov't Bond Index; Broad Fixed Income: Barclays U.S. Aggregate Index; Broad Domestic Equities: Russell 3000 Stock Index; Global ex-US Equities: MSCI ACWI ex-US Index

\*A portion of the GeFONSI was transferred to the GeFONSI II during Fiscal Year 2018 (January 2018)

Current Fiscal Year market values and stated returns are unaudited, preliminary, and include some estimates.

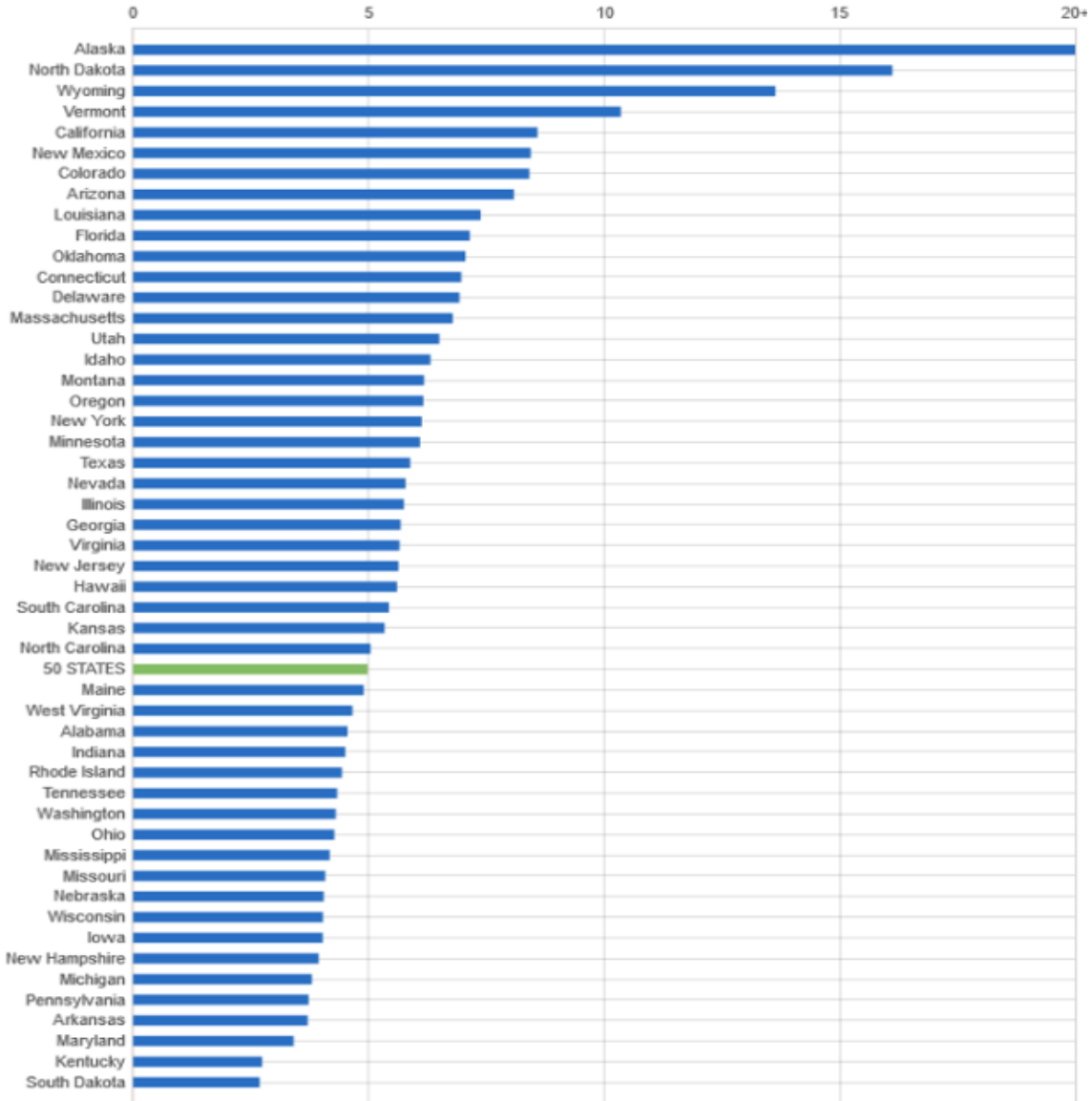


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# **Revenue Volatility Management**

# Alaska has the highest Tax Revenue Volatility

Higher values indicate greater volatility.



Source: Pew analysis of 1998-2017 data from the National Association of State Budget Officers

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# Revenue Volatility Now Comes From:

- **Commodity Volatility**

- Petroleum revenues are 28% of FY21 projected unrestricted general fund revenues
- Uncertainty exists "in-year" for FY21
- Will always have in-year uncertainty because we base budget on in-year oil collections

- **Investment Return Volatility**

- Investment earnings are 62% of FY21 projected unrestricted general fund revenues
- Certainty exists today for FY21 (lagging POMV formula)
- Uncertainty today for FY22 and beyond

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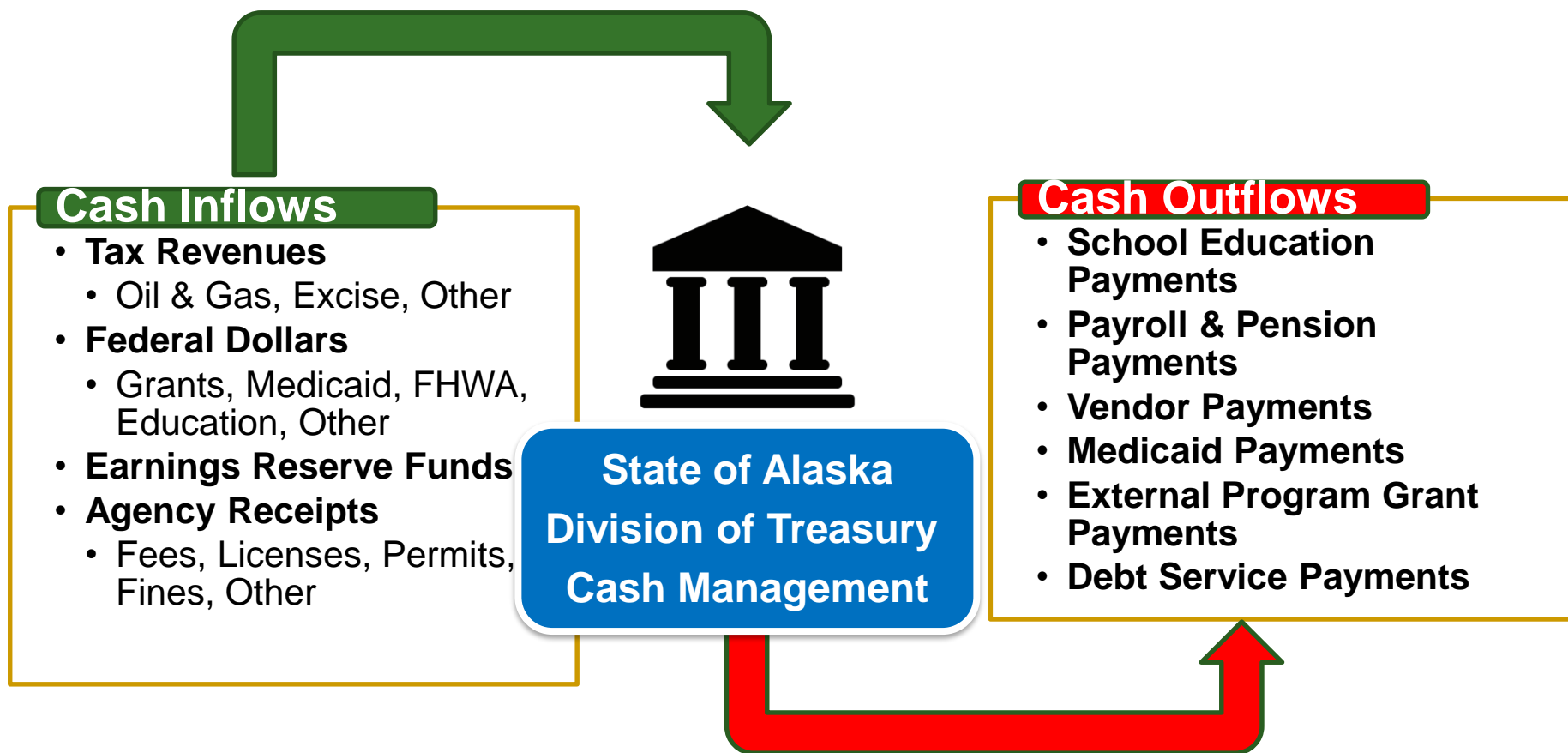
# Volatility Management Techniques

- Rainy Day and Other Funds (CBR and other fund balances)
- Oil Price Hedging
- Lagging PF Distribution Formula
- Distribution Formula Alternatives (Harvard/Yale/Tobin)

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# **Discussion of State Cash Flows**

# SOA Treasury Cash Flow



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## Cash Management Objectives

- Maintain adequate liquidity (\$400 million)
- Optimize cash resources.
- Safeguard State assets.
- Record financial activity affecting cash.

## Cash vs. Accrual balances

- Cash balance is what you have in the bank at a given point in time.
- Accrual balance takes into account what you have earned and when a liability is incurred at a particular point in time. It is what you should have at a particular point in time after all expected receipts and expenditures come in and out.
- Simple example: Your bank balance shows you have \$1,000 in cash at July 31. However, you know that you wrote checks for utilities on July 25 for \$400 that are for July utilities that have not yet cleared. You may have also earned a pay check of \$1,200 for work performed in July. Your accrual balance at July 31 would be \$1,800.



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## Cash Flow Deficiencies

- Prior to 1985, most unrestricted revenues flowed into and stayed in the General Fund for expenditure.
- Over time, the legislature has established many subfunds to segregate cash for budgeting purposes, resulting in less cash available to pay day-to-day operating costs.
- Expenditures can occur prior to receipt of revenue, resulting in a cash flow deficit:
  - Federal programs require expenditures before reimbursement.
    - i.e. Medicaid, Transportation, etc...
  - Beginning of year appropriation transfers do not match incoming revenue.

## Cash Flow Deficiencies

- Borrowing from budget reserve funds has been the solution of both cash shortages (cash flow deficits) and revenue shortfalls (budget deficits).
- During FY93-FY05, the legislature included language in the appropriation act permitting borrowings from budget reserve funds.
- The CBRF was fully repaid by FY10.
- Borrowing from the CBRF recommenced in FY14
- Per FY18 CAFR \$9.9B is owed to CBR

## Cash Deficiency Memorandum of Understanding

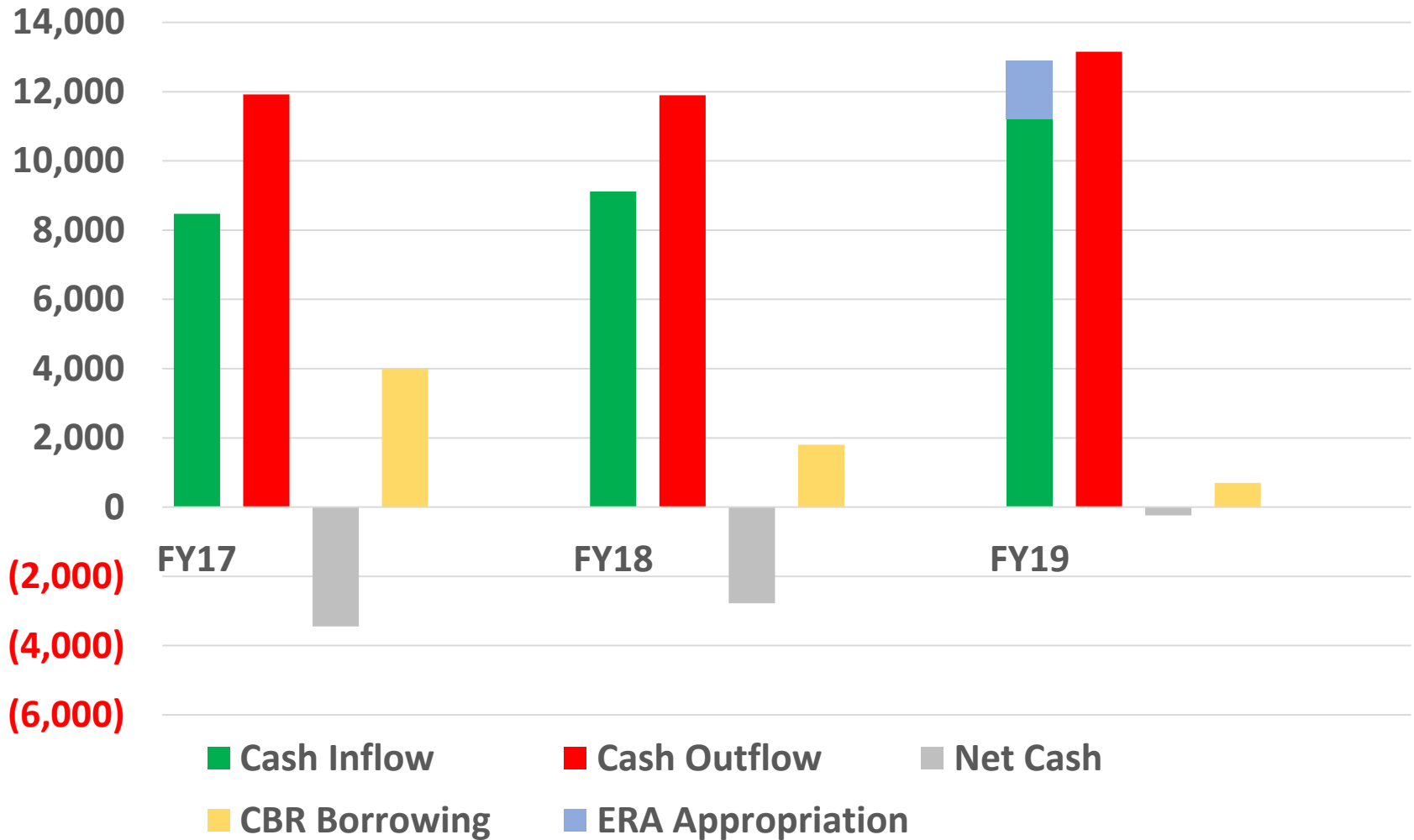
- Original MOU signed 1994 by DOR, DOA, OMB & LAW.
- Updated December 1, 2017.
- Targets \$400m dollar minimum threshold.
- Outlines procedures for addressing cash deficiencies:
  - Develop monthly cash projections.
  - Monitor daily general fund cash balances.
  - Transfer from SBR, CBR & ERA as appropriated.
  - Perform temporary interfund borrowing.
  - Borrow from general fund sub funds, if temporary
  - If all appropriations/borrowing are exhausted:
    - Seek legislative action through the Governor to access additional funds through appropriation from other Rainy Day Funds discussed above.
    - Prioritize disbursements, restrict expenditures.

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# **CASH FLOWS IN THE GEFONSI OPERATING ACCOUNT**

# Historic Actual Cash Inflows and Outflows FY 2017 – 2019\*

(in millions)



\*Includes all cash inflows and outflows from the State's operating account. Cash inflows and outflows will be greater than revenues and expenses because they include transfers between funds.

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## Seasonal Cash Flow Fluctuations

- June – Annual oil & gas property tax revenue.
- July – Debt service payments.
- Re-appropriation (July & August):
  - Finishing prior FY expenditures + current FY expenditures.
  - Allocating funds in or out of GF per new legislation.
- Summer – Peak season for construction projects and seasonal workers.

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# **CASH IN THE GENERAL FUND PROPER**

## Daily General Fund Sufficiency Balance Calculation



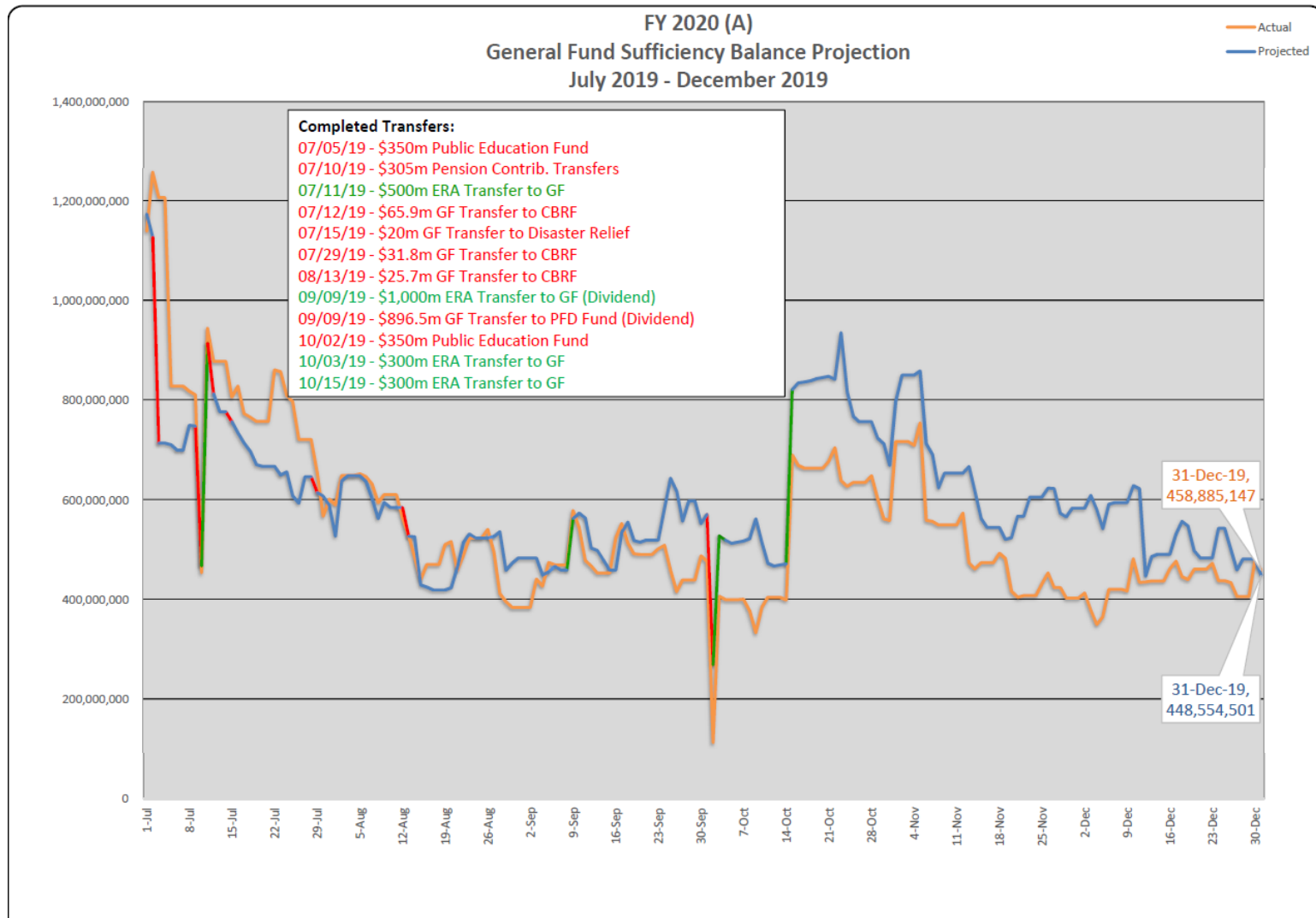
**\*Receipts not yet cleared by agencies, may not be GF money**



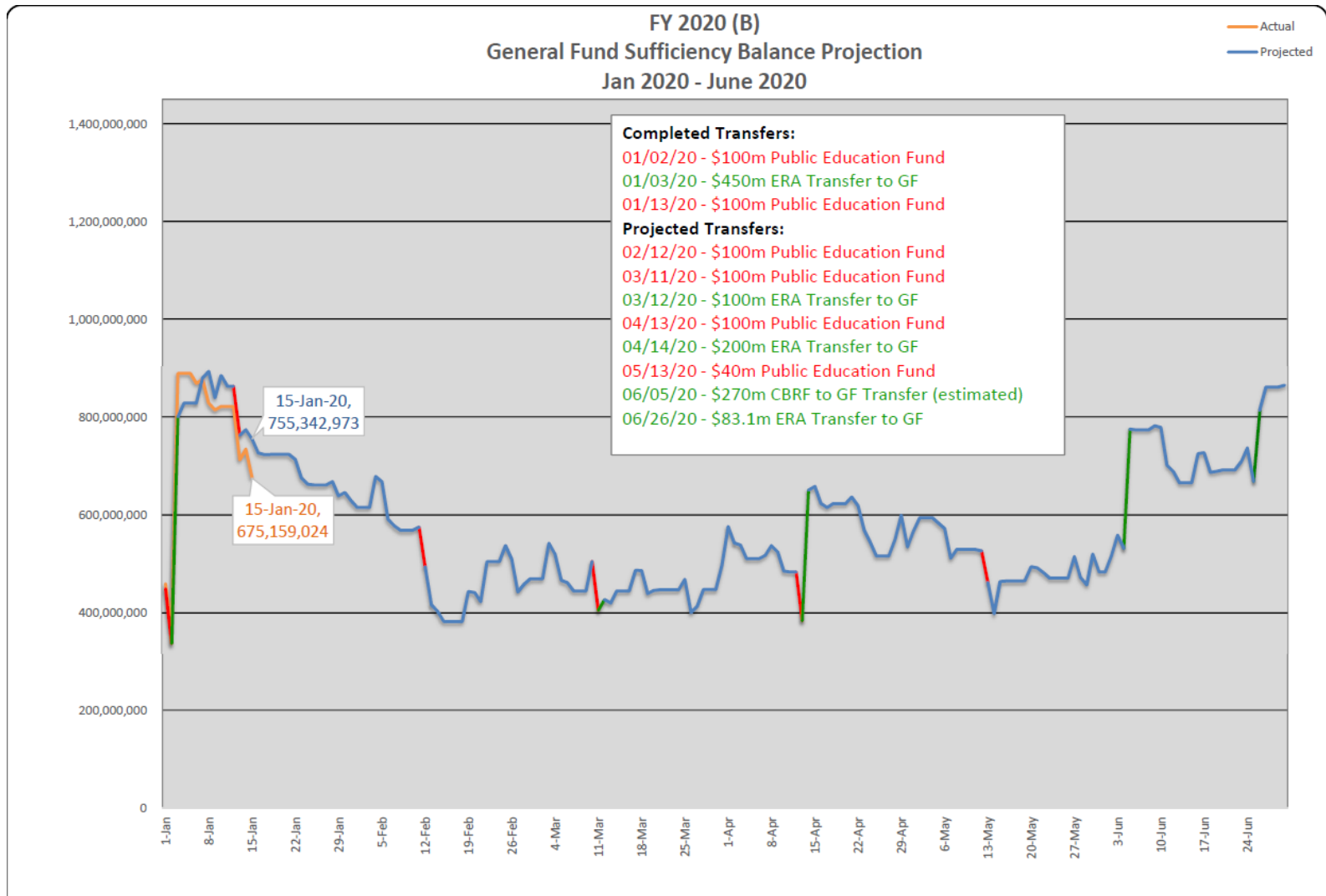
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# **FY2020 GENERAL FUND FORECAST**

# General Fund Sufficiency July 1, 2019 – December 31, 2019



# General Fund Sufficiency January 1, 2020 – June 30, 2020

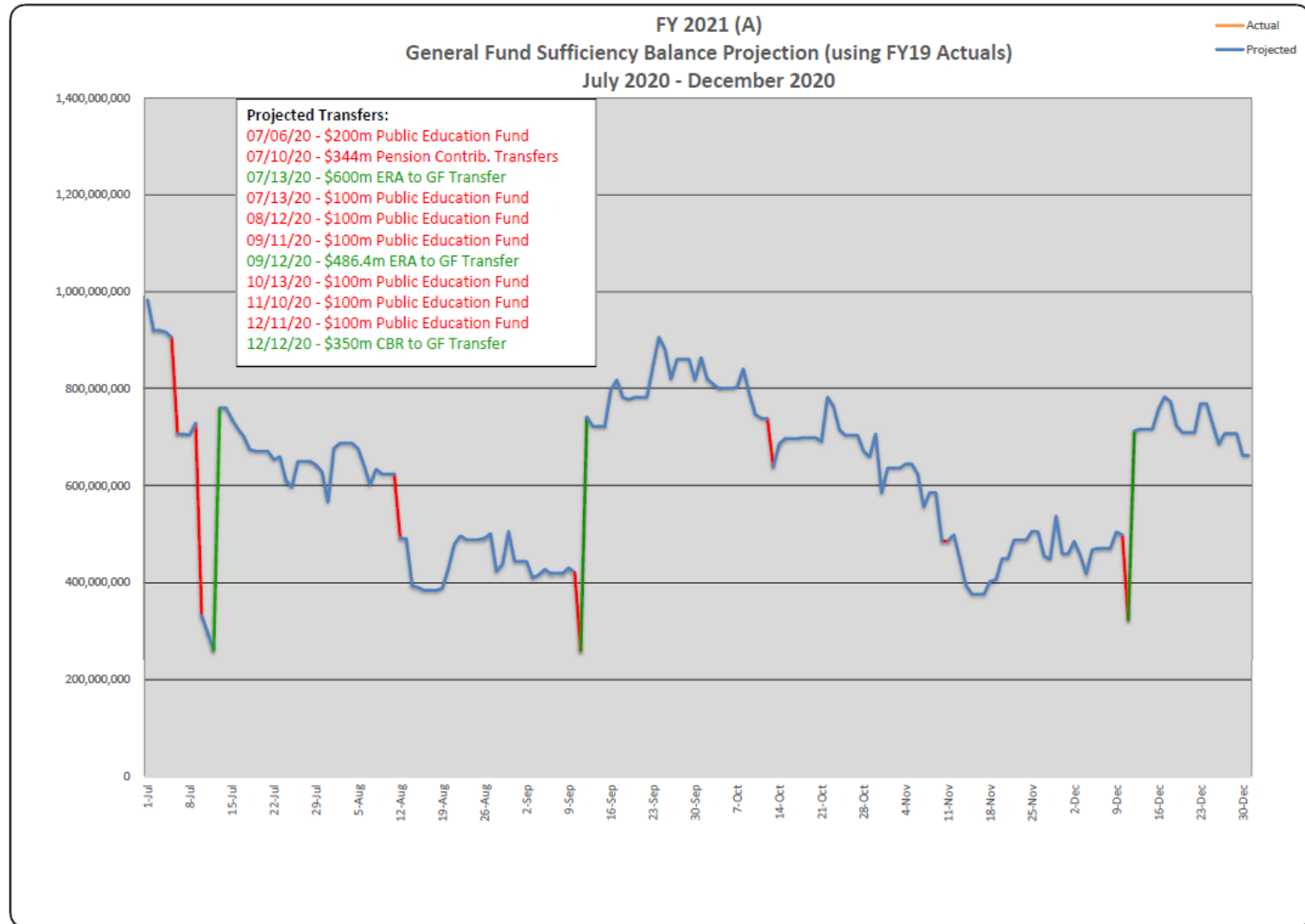


Assumes cash flows are consistent with FY19 actuals, updated for FY20 education and other fund transfers, and projected oil prices  
 Disclaimer: Actual cash flows will differ from projections based on the price of oil and timing and amount of expenditures

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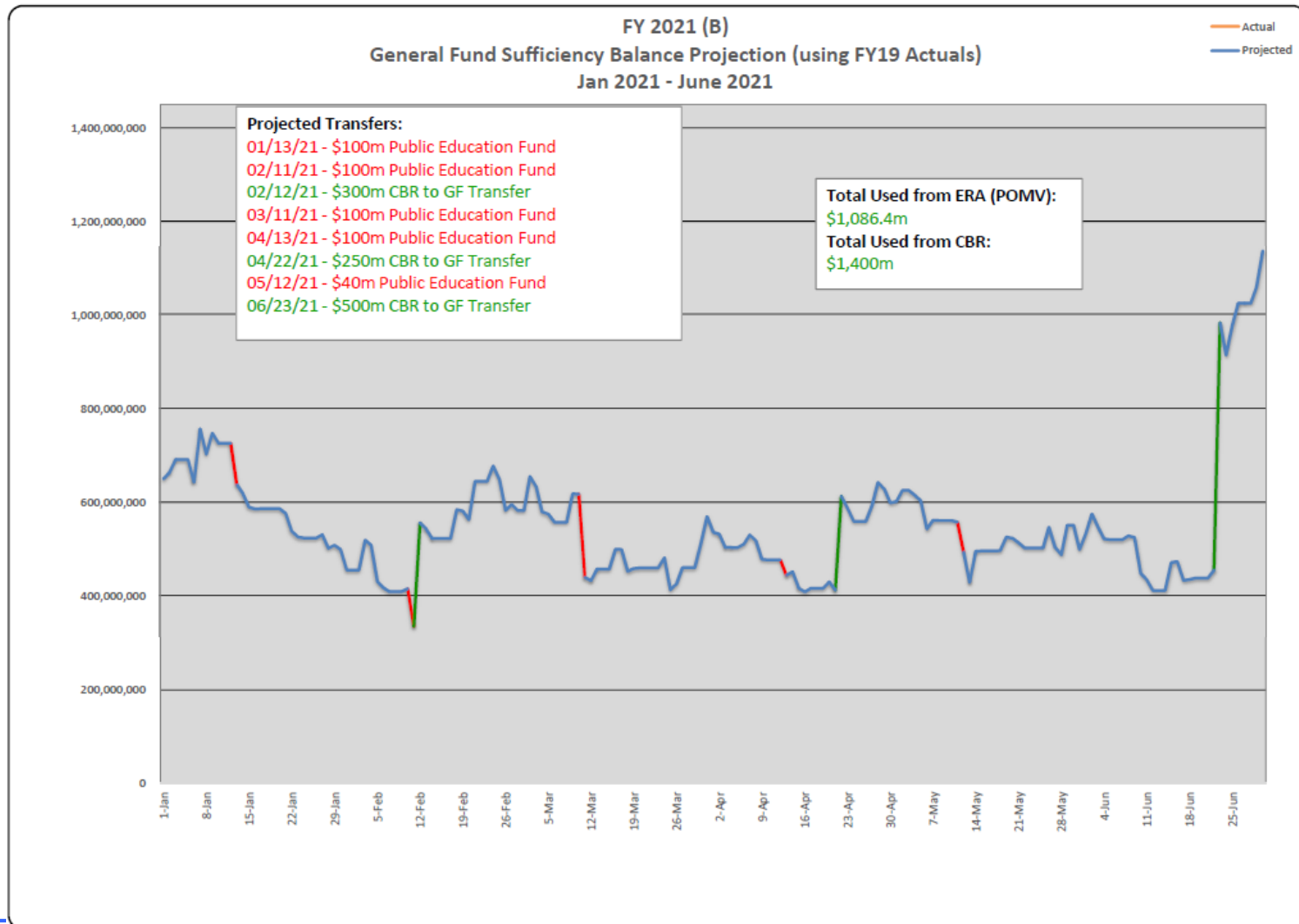
**FY2021  
GENERAL FUND  
FORECAST  
(using FY19 actuals)**

# General Fund Sufficiency July 1, 2020 – December 31, 2020



Assumes cash flows are consistent with FY19 actuals, updated for FY20 education and other fund transfers, and projected oil prices  
 Disclaimer: Actual cash flows will differ from projections based on the price of oil and timing and amount of expenditures

# General Fund Sufficiency January 1, 2021 – June 30, 2021



Assumes cash flows are consistent with FY19 actuals, updated for FY20 education and other fund transfers, and projected oil prices  
 Disclaimer: Actual cash flows will differ from projections based on the price of oil and timing and amount of expenditures

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# Take Aways

- Cash flow forecasting is always wrong.
- Even if the State budget is balanced, borrowing for cash flow deficits will occur.
- Budget deficit borrowing may occur if forecasted assumptions are wrong.
- How much is borrowed depends on the actual amounts and timing of revenues and expenses.
- Higher Revenue Volatility requires greater Rainy Day fund reserves.
- Volatility management techniques are available.

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# THANK YOU

Please find our contact information below:

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