State of Alaska
Department of Revenue

HB 92
Revenue Volatility Tools

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April 16, 2021

Office of Governor
MIKE DUNLEAVY

Agenda

- Goal
- Limitations of current statutes (AS 43.08)
- Cash Flow Mismatches
- Access/Harm to Other Funds if needed for cash management
- Benefits of modernizing financing tools
- Mechanics of the Bill
- Questions

Goal of HB 92: Improve cash flow management

Addresses cash flow <u>MISMATCHES</u>, not deficits.

- Current statute AS 43.08 allows for "Revenue Anticipation Notices" (gold circles) which is only one of short term borrowing structures, and not always the best fit
- Bill enables access to short term debt management tools available in the market i.e.

Capital Market Products

- Commercial Paper (CP)
- Variable Rate Demand Bonds (VRDBs)
- Floating Rate Notes (FRNs)
- Revenue Anticipation Notes
- Bond Anticipation Notes (BAN)

Bank Market Funded Products

- Draw-Down Term Loan
- Revolving Line of Credit
- Direct Purchase Index Floater (DPIF)
- Direct Purchase Revenue Anticipation Notes
- Direct Purchase Bond Anticipation Notes

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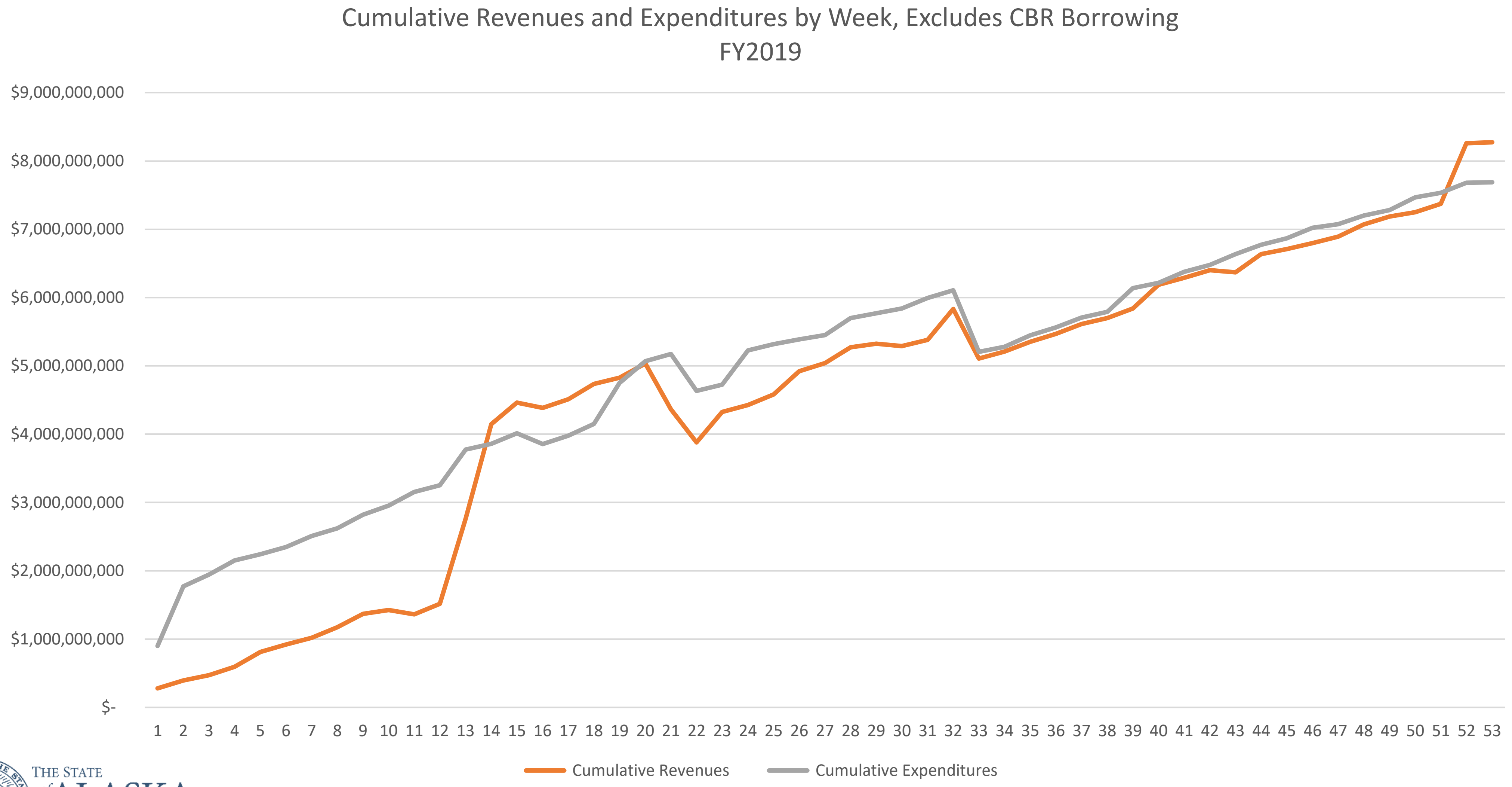
Cash Flow Mismatches

- $400M is minimum balance needed to manage cash flow
- Expenditures can occur prior to receipt of revenue, resulting in cash flow timing mismatches:
  - ✓Federal programs require expenditures before reimbursement - Medicaid, Transportation, etc.
  - ✓Beginning of the year appropriation transfers and cash flow needs - State pension payments, transfers to subfunds, construction peak season in summer.
- Cash flows may be impacted by external events:
  - ✓Spike in Medicaid expenditures.
  - ✓Federal Shutdown.

Cash Flow Mismatches



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Current Access to other funds

March 31, 2021	Current Balance	Target Return	Fiscal YTD Actual Return	Fiscal YTD Net Income
APFC Uncommitted Earnings Reserve Account*	$13 Billion	CPI +5.0%	17.72%	$11.8 Billion
Power Cost Equalization	$1.1 Billion	5.0%	10.08%	$106.0 Million
Higher Education Fund	$0.4 Billion	6.40%	20.51%	$69.0 Million
Constitutional Budget Reserve	$1.07 Billion	2.25%	0.17%	$1.8 Million
*APFC data is as of February 28, 2021. FYTD net income is for the entire fund.				

- Borrowing from funds with higher return targets results in decreased earnings due to lower balances on which to earn returns and potential losses due to market timing of security sales.

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Benefits

- Enables the Treasury and APFC to maximize returns and income
  - ✓ Takes advantage of low short term interest rates. Today’s cost for $100 million - 12 months:
    - ✓ Commercial paper - .8% (.2% interest plus.2% cost of issuing and liquidity cost of .4%)
    - ✓ Line of Credit – .55% (75% fixed rate of .4% plus .2% interest when drawing down and .15% costs of issuing)
    - ✓ Weekly VRDN - .74% (.04% interest plus .2% cost of issuing, .1% remarketing and .4% liquidity cost)
    - ✓ RANS - .36% (.16% interest plus .2% cost of issuing)
  - ✓ Enables current funds to remain in longer lived higher interest-bearing accounts (APFC, CBR, PCE, Higher Ed, etc) earning more income
    - Scheduling of POMV payments
    - Improved liquidity management
  - ✓ Enables quick access to funds in case of emergency

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Hypothetical Example of Potential Benefit

Projected $400 million intra-fiscal year deficit

(assumes all funds are borrowed immediately for 12 months, low rate of earnings CBRF, high rate total return of APFC)

Mode of borrow	RAN	VRDN	CP	LOC
Cost of borrowing	.36%	.74%	.8%	.55%
Low earnings	2.75%	2.75%	2.75%	2.75%
High earnings	6.75%	6.75%	6.75%	6.75%
Arbitrage Income generated as a result of borrowing	**$9.6 to $25.6 million**	**$8 to $24 million**	**$7.8 to $23.8 million**	**$8.8 to $24.8 million**

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HB 92 Mechanics

- Funds borrowed would be repaid no later than the fiscal year following issuance
- Repayment of funds would be made from revenues anticipated within the fiscal year in which funds are borrowed
- The borrowing pledges the full faith, credit, resources, and taxing power of the State of Alaska (identical to general obligation bonds)
- Due to the size of Permanent Fund earnings tax-exemption may not be available for the borrowing
- Provides structural alternatives to the currently authorized revenue anticipation notes that are available in today's short-term market

Questions ??

Variable Rate Overview (publicly offered structures)

	Bank-Backed		Non-Bank-Backed			
	Variable Rate Demand Bonds	Commercial Paper	Floating Rate Notes ("FRNs")	Self-Liquidity Commercial Paper	Synthetic Floating Rate	Extendible Securities
Summary	■ Long-term final maturity ■ Rates reset either weekly or daily ■ Callable anytime ■ Bank credit common ■ Proven product with substantial investor base	■ Maturities range from 1 to 270 days ■ Easy to "ramp up and down" balance ■ Callable on CP maturity date ■ Bank credit common ■ Proven product with substantial investor base	■ Fixed spread to SIFMA or LIBOR ■ Short maturities (1-5 years) or long-dated maturities with short-term "hard put" ("soft put" growth in tax exempt market) ■ No bank facility ■ Normally callable 6 months before maturity or put date	■ Highly rated issuers can use own assets to provide liquidity for traditional variable rate products ■ Rates compelling due to investor exposure to major LOC providers ■ Requires high level of unrestricted assets and strict procedures	■ Fixed rate bond with short maturity (1-5 years) or long-dated maturity with short-term put ■ University receives fixed payer rate from counterparty and pays LIBOR ■ Non-call until short maturity or put date	■ Remarketing agent sets rate and existing investors can retain bonds, and if not, University has specified period to find new investors ■ Extension period at higher rate for specified period allowing time to find alternatives
Risks / Considerations	■ Put risk ■ Bank facility renewal risk ■ Exposure to financial counterparties ■ SBPA termination for certain issuer events ■ Interest rate risk ■ Tax risk ■ Credit risk	■ Rollover Risk ■ Bank facility renewal risk ■ Exposure to financial counterparties ■ SBPA termination for certain issuer events ■ Interest rate risk ■ Tax risk ■ Credit risk	■ "Hard put" and "soft put" common in tax-exempt market; "Hard put" common in taxable market ■ Rollover/Refinancing risk ■ Potential increase in rating agency scrutiny ■ Interest rate risk ■ Size constraints ■ Credit risk at maturity or put date	■ Rollover Risk ■ Event of default if funds cannot be immediately accessed to fund investor puts ■ Potential increase in rating agency scrutiny ■ Interest rate risk ■ Tax risk ■ Credit risk	■ Rollover/Refinancing risk ■ Requires interest rate swap ■ Exposure to financial counterparties ■ Potential increase in rating agency scrutiny ■ Swap termination risk ■ Interest rate risk ■ Credit risk	■ Event of default if unremarketed after extension period ■ Limited liquidity and investor base ■ Potential increase in rating agency scrutiny ■ Sizing could impact pricing ■ Interest rate risk ■ Credit risk

Variable Rate Overview Bank Market Structures

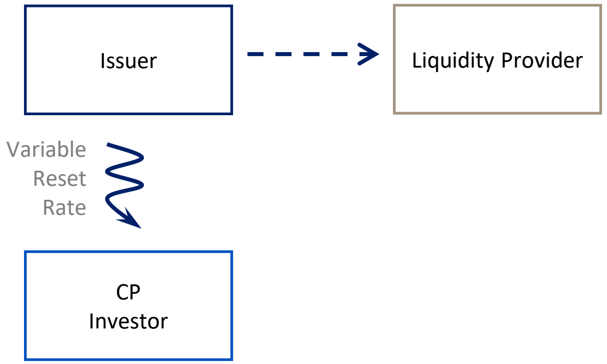
(Line of Credit)

Private Bank Market Structures
■ Typically up to 10 years, funded or unfunded, taxable or tax exempt ■ Flexibility in terms ■ Ratings not required ■ Official Statement not required
■ Rollover/Refinancing risk ■ Potential increase in rating agency scrutiny ■ Interest rate risk ■ Credit risk ■ Tax risk ■ Pricing increase risk for downgrades ■ Other standard provisions found in bank documents

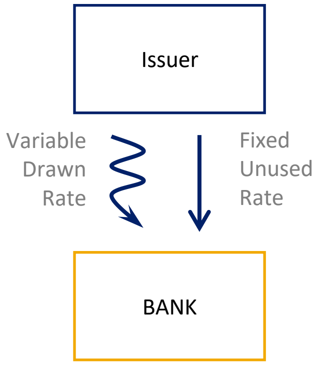
Variable Rate Overview and Considerations

Fixed vs. Floating Rate Debt: Flow of Capital

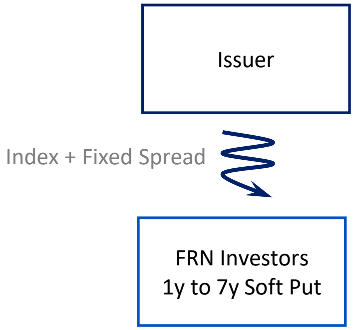
Commercial Paper ("CP")



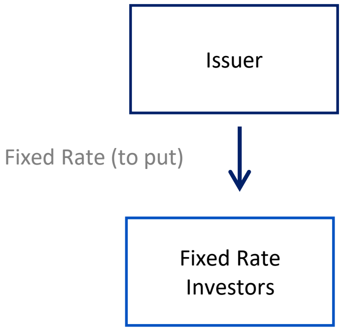
Line of Credit Purchase Agreement



Floating Rate Notes ("FRNs")



Revenue Anticipation Notes



Variable Rate Demand Bond ("VRDB")