

MINUTES
SENATE FINANCE COMMITTEE
February 05, 2002
9:40 AM

TAPES

SFC-02 # 5, Side A

CALL TO ORDER

Co-Chair Pete Kelly convened the meeting at approximately 9:40 AM.

PRESENT

Senator Dave Donley, Co-Chair
Senator Pete Kelly, Co-Chair
Senator Loren Leman
Senator Lyda Green
Senator Gary Wilken
Senator Alan Austerman
Senator Lyman Hoffman
Senator Donald Olson

Also Attending: ANNALEE MCCONNELL, Director, Office of Management and Budget; DEVEN MITCHELL, Debt Manager, Treasure Division, Department of Revenue

SUMMARY INFORMATION

SB 247-REAPPROPRIATIONS & CAPITAL APPROPRIATIONS

The Committee heard an overview from the Office of Management and Budget and the Department of Revenue. The bill was held.

#SB247

SENATE BILL NO. 247

"An Act making capital appropriations and reappropriations, and capitalizing funds; making appropriations under art. IX, sec. 17(c), Constitution of the State of Alaska, from the constitutional budget reserve fund; and providing for an effective date."

This was the first hearing for this bill in the Senate Finance

Committee.

Co-Chair Kelly noted the purpose of this meeting is to hear an overview of the FY 03 capital budget as proposed by Governor Tony Knowles. He stated that the Committee would have an opportunity to hear presentations on specific projects from department representatives in future hearings.

ANNALEE MCCONNELL, Director, Office of Management and Budget, shared that the Department has "a tremendous amount of information" about the FY 03 proposed capital budget available on the Internet via the Office of Management and Budget website at www.gov.state.ak.us/omb.

Ms. McConnell stated that 65 percent, the largest share of the funding is allocated to transportation projects. She noted this is consistent with previous years. She pointed out the next largest increment of 17 percent is for health and safety projects. She referenced a handout: Governor Knowles' Proposed FY 2003 Capital Budget Overview [copy on file.], which lists the projects by major categories.

Ms. McConnell stressed the proposed budget leverages the maximum amount of federal funds possible. She stated that 73 percent of the total budget proposal is federal funds. She noted the general fund source comprises 12 percent of the budget and represents the same dollar amount of \$114 million, as the current budget.

Ms. McConnell then spoke of dividend funding sources included in the proposed capital budget: the Alaska Housing Finance Corporation (AHFC) dividend, the Alaska Industrial Development and Export Authority (AIDEA) dividend and the Postsecondary Education Commission dividend. She commented that a "positive trend in recent years" has been to include AHFC and AIDEA dividends in the capital budget rather than the operating budget. This budget, she said, proposes to transfer the Postsecondary Education Commission dividend as well.

Ms. McConnell stated this budget reflects "some pretty significant increases" in the amount of general funds necessary to secure federal funds. For example, she said approximately \$20 million additional general funds are needed for transportation projects and \$4.7 million for water and sewer projects.

Ms. McConnell informed the amount of federal funds available is less than in the FY 02 budget, which had included \$93 million for "earmarked" specific projects and \$33 million for Alaska Marine Highway System projects. She assured there "is still a lot of

unknown territory in the federal budget for this year" and that funding has been allocated later in the year than normal. The delays, she attributed to the increased attention devoted to homeland security. As a result of the delays, she shared that amendments would continually be submitted to this budget to reflect upcoming federal appropriations.

Ms. McConnell remarked other state matching fund appropriations are included in this budget that are not for identified priority projects, but rather are necessary to meet new federal requirements relating to child protection and health insurance. She explained that recently adopted federal laws provide that the state must make "substantial changes" to the management information system. She said these appropriations are included in the Department of Health and Social Services portion of the budget and utilize federal funds and matching general funds.

Ms. McConnell commented the "general fund/match" category has historically been used in project proposals to indicate that state general funds are necessary to garner federal funding. However, she said a similar category does not exist in the detailing for those projects utilizing AHFC dividends and other non-general funds as the required matching funds. She gave sewer and water projects as an example. As a result of this discrepancy, she said the actual amount of state funds necessary to garner federal funding is understated. She suggested creating a designation for the non-general funds used as matching funds.

Ms. McConnell next addressed bond proposals, which although not included as part of the proposed capital budget, "could play a very large role in our capital infrastructure proposals for the public this year." She stated that two bond proposals exist for the current fiscal year and in addition, the Governor recently submitted two new bond proposals to the Legislature.

Ms. McConnell spoke to the recent proposals, one of which requests \$212 million for school construction and major maintenance. She told of the decision to include these projects in a general obligation bond package rather than as a part of the regular capital budget. She surmised that if bond proposals receive voter approval in the next three general elections, the entire backlog of school construction and major repair projects would be addressed. At this point, she continued, it would be possible to have an annual capital budget of between \$80 and \$100 million specific to schools that would be paid with "cash" or bond revenues. She concluded this method would address rural and urban needs throughout the state.

Ms. McConnell listed the deferred maintenance bond proposal for \$136 million as the second proposal submitted this session. She spoke to the efforts of the legislative Deferred Maintenance Task Force in identifying the needs.

Ms. McConnell remarked the reason for recommending the four bond proposals at this time is the "particularly good environment right now for bonding." She explained that interest rates are currently low, which could be advantageous. She relayed that Government Finance Associates, the state's bond advisors, were consulted and subsequently advised, "The long-term tax-exempt interest rates have been at their present low levels only about ten percent of the time since 1983." In addition, she said, the advisors instructed that changes to federal tax regulations relating to the comparative rating currently under consideration could make the bond market less desirable in the future.

Ms. McConnell shared that Administration had considered whether to include all of the requested deferred maintenance projects in the bond package or to include some in the FY 03 capital budget proposal. The decision was made, she said, to list some of the projects in the capital budget in order to maintain the "basic level" of funding for deferred maintenance projects in the capital budget. She gave as one reason the assumption that even with a bond package, basic repair needs to ensure the life of a facility, such as roof repairs, would remain. She also noted the difficulty in "restoring" these expenditures in a budget once they have been paid with other one-time funds.

Ms. McConnell next advised there would be no debt service incurred on these bonds in FY 03 due to the timeline involved and when the bonds would be sold. She stated that the total maximum debt service for the four bond packages would be approximately \$39 million, and would be approximately \$29 million in FY 04.

Ms. McConnell noted that the intent of the proposed bond package for harbor projects is to continue the process of previous AHFC and tobacco settlement funded bonds, "to bring harbors up to basic level of good repair" then transfer ownership to local governments. She listed the benefits to local communities as economic development potential and the elimination of dependency on the state government to perform maintenance and repair. She noted the current bond package addresses the remaining harbor projects in communities that are "willing and able" to take ownership.

Co-Chair Kelly asked if every project included in the current harbors bond package has the purpose of conducting repairs and improvements to allow transfer of ownership.

Ms. McConnell responded that only one project is not connected to an ownership transfer. She detailed the U.S. Corps of Engineers project in Wrangell and explained it is included in the package to coincide with several other Wrangell harbor projects that are tied to ownership transfers, which would allow all Wrangell projects to be undertaken simultaneously.

Ms. McConnell stated that amendments to the current harbor bond package would be submitted to add several projects located in communities that were unable to assume ownership when the original package was compiled. She noted that 31 harbors would be transferred from state to local ownership, many in the same communities. She listed the total package amount as \$39 million in revenue bonds, which would be repaid with proceeds from the existing marine fuel tax.

Co-Chair Kelly then asked about the Certificate of Participation (COP) process and how it is applied to deferred maintenance projects.

Ms. McConnell replied that rather than issuing a lease for every facility that has a deferred maintenance project; four or five select facilities would "stand in" for the whole package.

DEVEN MITCHELL, Debt Manager, Treasury Division, Department of Revenue, testified the COP structure has been used in the past for stand-alone facilities, such as the recent Department of Health and Social Services laboratory in Anchorage, the Fairbanks Courthouse, Kenai Courthouse, and the Spring Creek Correctional Facility in Seward. He explained the method of granting a title interest to a trustee bank, after which the Department of Administration enters into a lease with that trustee bank for the amount of the debt service on bonds that would then be sold. He said this lease is the "revenue stream" that provides the security to bond holders, thus the name: certificate of participation, since the bondholders are participating in the lease through the certificates they purchase. At the term of the lease, he continued, ownership, or lien interest held by the trustee bank, is relinquished and the free and clear title is returned to the State of Alaska.

Mr. Mitchell next spoke of the differences in how this process would be applied to a multitude of smaller deferred maintenance projects. He anticipated that a few of the highest value facilities would be selected and that leases for these facilities would be offered. He expanded saying, a limited number of leases would represent value to bondholders in an amount that could leverage a revenue stream through those leases to pay debt service on the

bonds.

Co-Chair Kelly requested further explanation. He understood that a specific amount of funds are needed to undertake the dozens of deferred maintenance projects and that a trustee bank "holds the paper" for these funds, but he questioned why there is no actual property involved as there is in a lease. He asked what is purpose of selecting a limited number of high value facilities.

Mr. Mitchell responded the reason for having a limited number of facilities is ease of transaction. He stated that issuing over 200 title interests, one for each facility with a proposed deferred maintenance project, would not be practical.

Co-Chair Kelly clarified that the title of a facility in a stand-alone project is given to a trustee bank in the amount of the estimated cost of the proposed project. He asked if in this deferred maintenance situation, titles for a few facilities would be issued with liens in the amount estimated to complete the projects for all the facilities. He likened this method to using the value of a few facilities as collateral.

Mr. Mitchell affirmed and added that the trustee bank and the bondholders are not interested in ownership of the facilities in the same manner a mortgage holder is not interested in owning a borrower's house. He noted the State of Alaska makes a "pledge" to provide an annual appropriation to cover debt service, which he said is the "strength behind" the COP.

Senator Hoffman asked if the trustee bank purchases insurance to protect against the possibility of future legislatures failing to make debt service appropriations.

Mr. Mitchell replied that there are not specific insurance requirements. He qualified that the state is required to insure the facility offered for lease in the same manner it must insure any state-owned facility. He pointed out however, there is "a means of adding value to the transaction" through bond insurance. He elaborated that the deferred maintenance bond package would be considered a typical state-supported debt and would receive a rating of "A" compared to the "AA" rating the state receives for its general obligation bonds. He said the lower rating is because of the "lesser pledge" involved. He continued that bond insurance could be purchased for an "up front fee", which correlates to an interest rate increase, and would increase the rating from "A" to "AAA". He said the increased rating provides additional security to bondholders; in the event the state failed to pay, the claim would be honored through this insurance. In this instance, he remarked,

the insurance company would then pursue the state directly for repayment.

Senator Hoffman referenced other pending legislation sponsored by Senator Green relating to a COP for construction of correctional facilities throughout the state. He asked if the process would be the same for correctional facility projects as the witness described regarding deferred maintenance projects.

Mr. Mitchell responded the process would be "similar but different". He explained Senator Green's legislation provides for the state to enter into leases with the communities in which the facilities would be located. The communities, he continued, would issue lease revenue bonds to provide improvements to the facilities then assume joint ownership of the facilities. He said this would be similar to the situation involving the Anchorage Fourth Avenue Jail since the state's revenue stream would provide security to bondholders.

Senator Hoffman next addressed the proposed \$212 million bond package for school construction and major maintenance projects. He asked for confirmation that construction of the included projects would occur over a two-year period, and it would be hoped that future legislatures and administrations would address the remaining identified projects. He asked why all the identified projects are not included in one bond package as opposed to the current plan to divide the projects into three bond proposals to be presented to voters in consecutive general elections. He stated that under the current plan voters would have to be educated on the matter repeatedly and convinced more than once to vote for a bonding measure. He suggested concentrating the efforts into "one sales pitch."

Senator Hoffman commented that because Alaska has not undertaken a major school construction effort for several years, only three new schools were built the previous year and "very few" were constructed in rural areas in prior years.

Ms. McConnell responded the matter could be addressed using either method. She said the current plan divides the number of projects into three portions of approximately \$200 million each; however, if combined into one bond package, it could be clarified that actual construction would occur over a period of several years.

Ms. McConnell added the school bond package gives "significant advantage" to communities. She explained that most urban school construction projects have been funded through school debt reimbursement programs with state reimbursement of 70 percent,

which requires the community to bond for 100 percent of the project cost using their own debt capacity. In contrast, she said this bond package would provide the state's 70 percent share to the community in the form of a grant. This method, she continues, also provides assurance to local governments that the state would contribute its full debt payment. She noted there had only been one instance where the legislature failed to appropriate the full reimbursement, but it is still a concern. She added that this method is more cost effective as well, because the state's bond rating is higher than municipalities and lower interest rates could be secured. She remarked school superintendents have supported this method for the aforementioned reasons.

Senator Leman then spoke to the harbor transfers effort, which he worked on as a member of the legislative Deferred Maintenance Task Force. He relayed that the task force oversaw several repair projects with subsequent ownership transfers. He asked if this bond proposal includes assurances that once the repair and maintenance projects are completed the transfers would actually occur.

Ms. McConnell replied the bond package is structured to stipulate that before the maintenance and repair projects are started, an agreement is entered into with the community. She noted the first ownership transfers were voluntary and the repair and maintenance projects were funded with AHFC bonds, which do not require ownership transfer. She recommended ownership transfer requirements for the proposed bond package projects.

Senator Leman supported transferring ownership of harbor facilities. He pointed out the witness' earlier testimony stated the projects consist of basic maintenance and repair items. He considered these as operating expenses, although he understood some maintenance and repair expenses are "over and beyond" basic on-going needs. He asked for clarification that the proposed projects were not for basic needs.

Ms. McConnell agreed that on-going maintenance could be addressed in the operating budget. However, she attested the proposed projects in this bond package are "gray area," because the needs have accumulated to the point that they could be considered as capital expenditures.

Ms. McConnell qualified the proposed deferred maintenance bond package includes some expansion or replacement projects. She explained these are instances where it has been determined that it is not feasible to repair the existing facility, such as the Ketchikan Public Safety Building. She suggested that to attempt to upgrade the existing facility would only "pour good money after

bad".

Ms. McConnell continued the proposed deferred maintenance bond package also includes \$4 million for projects relating to veteran's housing. She stated these funds would match \$6 million federal funds for the purpose of addressing housing needs for veterans who are ineligible for the Pioneers' Homes, due to age restrictions, but still require assisted living.

Ms. McConnell recommended the deferred maintenance bond package contain a "specific appropriate an amount per department" as is practiced currently with deferred maintenance appropriations in the capital budget.

Ms. McConnell also noted the package contains separate categories for Americans With Disabilities Act (ADA) projects at the University of Alaska and other government facilities. She pointed out that several large ADA upgrade projects are on the statewide priority list and would require more funds than are normally appropriated in the regular capital budget for facility upgrades.

Ms. McConnell informed that detailed information is available on the Internet about the estimated cost of each project. She cautioned that not all expenses could be anticipated. As an example, she gave a scenario of a roof repair project with additional structural damage discovered once the old roof is removed. However, she said, cost overruns would be absorbed within the bond allocation of the affected department rather than reallocated from a different department.

Senator Austerman assumed some of the figures listed in the handout are estimates because they do not equal the total amounts shown in the summary. He asked the simplest manner for him to locate and review the other fund sources involved.

Ms. McConnell referred to page 42 of the bill, which lists the appropriation amount proposed for each department. Page 46, she continued, has the aggregate total of every funding source for all departments. In addition, she noted the capital project summary lists the amount of each funding source for every project.

Senator Wilken noted past conversations about Grant Anticipation, Revenue Vehicles (GARV) bonds. He surmised this might be the year decide whether to take action. He suggested a Committee meeting to focus solely on GARV bonds to address concerns raised and gather information necessary to make educated decisions on the matter. He informed he has five specific questions. He also recommended notifying municipality representatives of this meeting and

encouraging them to observe for education purposes as well. He predicted this would foster discussions that could be based on an equal level of understanding.

Co-Chair Kelly agreed this was a good idea and assured such a meeting would be scheduled.

Ms. McConnell offered to address Senator Wilken's five questions beforehand, which she surmised might raise additional questions.

Ms. McConnell suggested it could be helpful to look at debt service in the same matter. She shared that it has been debated whether to include debt service payments in the capital budget rather than the operating budget to more accurately reflect capital expenditures.

Ms. McConnell elaborated on her earlier statements about the advantages of addressing capital infrastructure at this time. She said that in addition to the cost advantages of taking action now, other "large capital intensive efforts...are on the horizon," including a natural gas pipeline and military expansion. She opined the current "bidding atmosphere" is more advantageous than it would be with other large projects underway. She also stressed the need to ensure the level of construction activity is within the in-state capacity to undertake these projects. Otherwise, she cautioned, out-of-state contractors would be needed, which would not benefit Alaskan workers.

AT EASE 10:22 AM / 10:22 AM

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ADJOURNMENT

Co-Chair Pete Kelly adjourned the meeting at 10:23 AM.