

HOUSE FINANCE COMMITTEE  
April 6, 2005  
2:01 p.m.

CALL TO ORDER

Co-Chair Meyer called the House Finance Committee meeting to order at 2:01:20 PM.

MEMBERS PRESENT

Representative Mike Chenault, Co-Chair  
Representative Kevin Meyer, Co-Chair  
Representative Bill Stoltze, Vice-Chair  
Representative Eric Croft  
Representative Richard Foster  
Representative Mike Hawker  
Representative Jim Holm  
Representative Reggie Joule  
Representative Mike Kelly  
Representative Carl Moses  
Representative Bruce Weyhrauch

MEMBERS ABSENT

None

ALSO PRESENT

Cheryl Frasca, Director, Division of Management & Budget, Office of the Governor; Devon Mitchell, Executive Director, Alaska Municipal Bond Bank Authority, Department of Revenue; Mike Barnhill, Assistant Attorney General, Department of Law; Kelly Huber, Staff, Representative Nancy Dahlstrom; John Cramer, Director, Administration Services Division, Military and Veterans Affairs;

PRESENT VIA TELECONFERENCE

Cynthia Weed, Bond Counsel, Preston, Gates and Ellis, Anchorage; Dan Fauske, Executive Director, Alaska Housing Finance Corporation, Department of Revenue

SUMMARY

HB 122 An Act relating to payment of premiums for Service members' Group Life Insurance on behalf of members of the Alaska National Guard deployed to a combat zone; and providing for an effective date.

CS HB 122 (FIN) was reported out of Committee with a "do pass" recommendation and with a new fiscal note by the Department of Fish & Game, a new zero

note by the Alaska Postsecondary Commission, zero note #1 by the Department of Commerce, Community & Economic Development and fiscal note #2 by the Department of Military & Veterans Affairs.

HB 187 An Act establishing the Alaska capital income account within the Alaska permanent fund; relating to deposits into the account; relating to certain transfers regarding the Amerada Hess settlement to offset the effects of inflation on the Alaska permanent fund; and providing for an effective date.

HB 187 was HEARD and HELD in Committee for further consideration.

HB 188 An Act establishing the State of Alaska Capital Corporation; authorizing the issuance of bonds by the State of Alaska Capital Corporation to finance capital improvements in the state; and providing for an effective date.

HB 188 was HEARD and HELD in Committee for further consideration.

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Co-Chair Chenault reported that the first Alaskan Marine, Jeremiah Kinchen, was killed in Iraq on April 1, 2005. He requested a moment of silence.

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#HB122

HOUSE BILL NO. 122

An Act relating to payment of premiums for Service members' Group Life Insurance on behalf of members of the Alaska National Guard deployed to a combat zone; and providing for an effective date.

Representative Weyhrauch MOVED to ADOPT amended Amendment #3. (Copy on File). He pointed out that the original bill had raised questions regarding what the State could require.

Representative Hawker had discussed provisions in Section 2 with legal services. He noted the issues with potential interference when entering into contractual agreements, however, he did not want to discuss it further in Committee.

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KELLY HUBER, STAFF, REPRESENTATIVE NANCY DAHLSTROM, commented that the sponsor wanted to make one recommendation. There has been positive feedback on the

fill, but concern with "terminating an existing contract". She offered language to "suspend the contract" as an alternative, allowing the companies to decide and would offer guardsmen some relief.

Representative Hawker thought that could help but pointed out that the bill has a long way to go through the legislative process.

Co-Chair Meyer noted that Legal Services was okay with the current language.

Vice-Chair Stoltze OBJECTED to the amended Amendment #3.

Representative Weyhrauch WITHDREW the motion on amended Amendment #3.

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Representative Weyhrauch MOVED to ADOPT Amendment #4. Co-Chair Meyer OBJECTED for purposes of discussion.

Representative Weyhrauch explained that the amendment clarifies that if there is a penalty or cost, someone would have to be responsible and the party passing the law would be responsible. The amendment adds language clarifying that if someone is paying, it would not fall upon the shoulders of the private sector or the utility but rather the State of Alaska. He pointed out that Amendment #4 offers clarifying language.

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Ms. Huber noted that the sponsor does not support the amendment; the part of concern is the language, "other heating fuel". That had been added at the request of a member in the previous committee. The sponsor does not have concerns on issues raised by Representative Weyhrauch and that higher education already has an informal policy. Other reliefs only provide time and eventually they would still have to pay their bills. The legislative intent is to stipulate in law that penalties are not imposed.

Co-Chair Meyer thought that passing the amendment would change the fiscal note. Representative Weyhrauch disagreed. Ms. Huber reiterated that the bill clarifies that the companies would not have a penalty. No one had come forward voicing opposition nor did the electric companies show concern. Co-Chair Meyer inquired if in rare cases could there be additional costs to the State. Ms. Huber indicated that if in those cases, the State picked up the penalty costs and the amendment was adopted, there could be a fiscal impact.

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Co-Chair Chenault asked about heating fuel costs in rural Alaska. Representative Joule noted that he would have that information available for the House Floor session. He thought it would affect them.

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Representative Croft disagreed with the intent of the amendment. He believed that large impacts should be compensated. He thought that the legislation was relatively minor and that everyone should "be in it together". After reviewing the amendment, he said it was a cost that society should bare and that the bill already offers safeguards.

Co-Chair Meyer asked how often the National Guard is deployed.

JOHN CRAMER, DIRECTOR, ADMINISTRATION SERVICES DIVISION, MILITARY AND VETERANS AFFAIRS, stated currently there are 180 Alaska National Guardsmen deployed. Since 9-11, the country has entered into a new era of deployment, becoming more frequent. It is anticipated that by FY06, there will be around 300 Alaskan National Guard deployed.

Representative Weyhrauch WITHDREW Amendment #4.

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Representative Foster MOVED to report CS HB 122 (FIN) out of Committee with individual recommendations and with the accompanying fiscal notes. There being NO OBJECTION, it was so ordered.

CS HB 122 (FIN) was reported out of Committee with a "do pass" recommendation and with a new fiscal note by the Department of Fish & Game, a new zero note by the Alaska Postsecondary Commission, zero note #1 by the Department of Commerce, Community and Economic Development and fiscal note #2 by the Department of Military & Veterans Affairs.

#HB187

#HB188

HOUSE BILL NO. 187

An Act establishing the Alaska capital income account within the Alaska permanent fund; relating to deposits into the account; relating to certain transfers regarding the Amerada Hess settlement to offset the effects of inflation on the Alaska permanent fund; and providing for an effective date.

HOUSE BILL NO. 188

An Act establishing the State of Alaska Capital Corporation; authorizing the issuance of bonds by the State of Alaska Capital Corporation to finance capital improvements in the state; and providing for an effective date.

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CHERYL FRASCA, DIRECTOR, DIVISION OF MANAGEMENT & BUDGET, OFFICE OF THE GOVERNOR, commented that in early March 2005, there had been a meeting discussion in the House Finance Committee about establishing an account to use the funds, while the bills were still in the House Judiciary Committee. The bills did pass out of the Judiciary Committee and they relate to the same measures discussed that day. She commented this is the Governor's proposal, as a way to leverage interest earnings that the State is receiving on an account from a 1997 settlement reached with the oil companies. That proposal was to leverage average earnings and the Governor's proposal is to leverage approximately \$30 million dollars in annual interest earnings to issue bonds for financing additional capital projects outlined in the FY06 Capital Budget. The ultimate decision regarding the projects rests with the Legislature.

Ms. Frasca noted that Devon Mitchell would discuss the actual structure of the bills. HB 187 establishes the Alaska Capital Income Account, the account into which the annual earnings would be appropriated. HB 188 establishes the State of Alaska Capital Corporation, which would provide the way to leverage earnings to issue bonds. Alaska Housing Finance Corporation (AHFC) was online to address concerns and bond counsel would address specific concerns with bond issuance.

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DEVON MITCHELL, EXECUTIVE DIRECTOR, DEBT MANAGER ALASKA MUNICIPAL BOND BANK AUTHORITY, DEPARTMENT OF REVENUE, limited his remarks to questions that have come up regarding how the bills would be enacted. He referenced back-up material offered in member's packets. (Copies on File).

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Mr. Mitchell acknowledged that there was no reason why the two pieces of legislation could not be passed independently. He responded to a question from a previous committee regarding what would happen with potential leveraging if there were inflation proofing in the fund balance of the Amerada Hess settlement money. He claimed that there would be about a 37% reduction in annual revenue that would be

available to the Legislature. As time goes by, inflation proofing would fund the balance and eventually, the State would receive the full \$29 million dollars. The result would be a 36% reduced project list, an action that would provide quicker leveraging but would have a dramatic short-term impact.

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Mr. Mitchell noted that the listed 6% represents a conservative placeholder and demonstrates the viability of the Corporation's ability to borrow based on anticipated transfers. He thought that 17-years was indicative to the strength and borrowing rate that the State of Alaska currently has on corporate funds. He added that the ideas had been passed through the rating analysts that monitor the State of Alaska's credit. Initially, it was indicated that it would not be included in the State's supported average and was an important feature of the structure. Having been reviewed by a number of investment banks, they found that the structure would work and financing would be feasible.

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MIKE BARNHILL, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF LAW, offered to provide a background of the Amerada Hess settlement and/or speak to legal questions.

Ms. Frasca noted the memo included in the file from Cynthia Weed, Bond Counsel with the firm, Preston, Gates and Ellis, and dated 4/06/05, regarding the appropriateness of the projects.

CYNTHIA WEED, (TESTIFIED VIA TELECONFERENCE), BOND COUNSEL, PRESTON, GATES AND ELLIS, ANCHORAGE, noted that she was on line and offered to answer questions of Committee members.

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Co-Chair Meyer asked if the bond counsel was in support of the legislation and found the recommendations to be legal.

Ms. Weed explained that the bond counsel had worked with Mr. Barnhill in review the draft bills. Bond counsel believes that the structure of the corporation is consistent with the Alaska Constitution. Her firm provided a preliminary review of the initial projects and found that they were eligible for financing. The proposed tax exemption structure has not been finalized; it still would be possible to get bonds on a preliminary basis.

Co-Chair Meyer understood that the Amerada Hess fund would be a sub account and would not impact the Permanent Fund.

Ms. Weed thought that would be safe to say but requested confirmation from the Department of Law.

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Co-Chair Meyer asked about modifying the suggested project list. Ms. Frasca responded that if the Legislature could reduce it from \$340 million dollars down to \$200 million dollars and still fund it, she would say "go for it". Co-Chair Meyer admitted that there are concerns dedicating \$30 million dollar dividends over a 20-year period to purchase two years worth of capital projects. He mentioned a reduction to 10-years and asked if there was flexibility. Mr. Mitchell replied that there definitely is flexibility, which could make the financing more "do-able". The less leveraging of the potential revenue, the easier it is to attain high ratings.

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Representative Weyhrauch pointed out that the legal opinion was prepared two years ago and that the percent of market value had changed. He asked if it would still be legal and if the use of the Amerada Hess settlement funds to bond the projects would create a taxable event for the State of Alaska for the Permanent Fund.

Mr. Burnhill thought that Representative Weyrauch was referring to the Johnson opinion case, which addresses the extent to which the Permanent Fund is subject to federal income tax. The proposed legislation takes the stream of revenue earnings from the Permanent Fund, which currently are not being used for dividends and then designates them to finance the projects. It would not create a taxable obligation, noting that there is nothing illegal about it.

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Co-Chair Meyer inquired if instead, the State should be using Alaska Housing Finance Corporation monies.

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DAN FAUSKE, (TESTIFIED VIA TELECONFERENCE), EXECUTIVE DIRECTOR, ALASKA HOUSING FINANCE CORPORATION, DEPARTMENT OF REVENUE, stated that AHFC was involved in the original discussion with the Administration regarding how to create a bonding proposal utilizing general fund revenue. The original proposal was to use AHFC having a structure of using their own general obligation (GO) credit. Mr. Fauske advised the Administration that AHFC would not be able to get a favorable outcome from Wall Street as they are "tapped out" of GO credit. AHFC originally anticipated creating a sub corporation structure similar to what the Department of

Revenue currently does. As it turned out, it became clear that the Department of Revenue would be able to meet the needs.

Mr. Mitchell added that the analysis has indicated the amount of volatility. The Department wants to guarantee that if the revenue stream should fail, it would not become an obligation of the State of Alaska. The plan proposes to use the State's moral obligation for corporate credit for the proposed obligations. He stated it was important to have it near the Administration and the Department of Revenue.

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Mr. Mitchell advised that the Board would consist of:

- The Commissioner of the Department of Revenue,
- The Commissioner of the Department of Administration and
- The Commissioner of the Department of Commerce, Community & Economic Development.

The commissioners would have the ability to insure that the moral obligation was honored and that they were sending a message to rating analyst and agencies, this is a top priority for the State of Alaska.

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Co-Chair Meyer (inaudible).

Ms. Frasca asked if he was referring to the interest earnings being used for another public purpose.

Representative Kelly voiced concern with the proposed legislation. The public has voiced a grave concern with any invasion of the Permanent Fund. The people of the State have responded overwhelming. He recommended to move forward only with public inclusion. He understood that the Amerada Hess case was a "convenience" to make sure that judges would not be conflicted when receiving a dividend.

Representative Kelly reiterated caution that passing the proposed legislation puts the State into an area that the voters do not want go. He thought that the voters were smarter than the intent of the bill.

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Co-Chair Meyer state that initially had similar concerns as Representative Kelly, however, following a legal explanation, he had been put at ease.

Ms. Frasca interjected that the issue for most Alaskans and is how much their dividends will be. She thought that Alaskans were willing to put out a little to invest in their communities. Ms. Frasca pointed out that the legislation would help leverage dollars to prepare for Alaska's future. The intent is to leverage money to build the type of infrastructure needed to support the gas line. She acknowledged that the decision was politically "tuff".

Co-Chair Meyer pointed out that the money was not originally part of the actual Permanent Fund or the earnings. Ms. Frasca noted that it presently resides in the Permanent Fund. The earnings do get redirected to the Earnings Reserve Account and then appropriated each year into the Amerada Hess account. Those earnings are backed out when the dividend is calculated.

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Representative Kelly understood and maintained his concern. He reiterated that Amerada Hess had been an accident and did realize that Alaskans do demand more services than they are willing to pay for. The Governor does not think the Permanent Fund should be enshrined or that there should be a vote of the people. The legislation is a way into the fund from a "veiled" perspective and it is not "straight up".

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Representative Holm continued with Representative Kelly's "farm" analogy, stating that the earnings resemble "fertilizer". He understood the points delivered by the previous speaker regarding the public perception and questioned if they would buy the proposal.

Mr. Barnhill interjected that a characterization of segregation of the earnings in the Permanent Fund as an accident is not correct. When the legislation was enacted in 1989, the Amerada Hess royalty litigation had been going on for quite some time and there was a lot of money in that fund, well over a \$1 billion dollars. The Department of Revenue realized that they might have to litigate the case and the way to solve that would be to segregate any earnings into a sub account so that no earnings would flow into the Permanent Fund.

Mr. Barnhill continued, without the legislation, the progress of the litigation was impaired. The result of the litigation was \$194 million dollars for the State of Alaska. He said it definitely had value.

In reference to Representative Kelly, Mr. Barnhill maintained that the fence could be kicked down but as a

policy matter that choice should be considered seriously. There could be a future situation in which the State might have major litigation and the judge could not be able to preside as the money might flow into a dividend. If the same situation came up in the future, the solution may not be persuasive to a judge. It is within the Legislature's prerogative to do that, however, the Department of Law recommends against it. The bill proposes the middle ground, putting the earnings to some use for the State of Alaska.

Representative Kelly understood the reasons not to do that and believed there was no connection between the examples. The State's reasons are not persuasive.

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Vice-Chair Stoltze spoke to the importance of the dividend and protecting that program, however, he believed it could be fair game.

Representative Joule interjected that there are many proposals "popping up" around the building. Each proposal has something of concern regarding either the planning or the infrastructure. He cautioned about the "blendings".

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Representative Croft stated that there is a "huge philosophical debate" that will happen. He disagreed with the comment that it would not be use of the Permanent Fund earnings. They are clearly Permanent Fund earnings. Under the current statutory structure, it would not have an effect on the dividend. Mr. Barnhill agreed.

Representative Croft advised that there never had been a judicial determination in the direct line of that case. Mr. Barnhill countered that there have been so many judges that have weight in on the matter. He referenced the chronology of the case included in the packets and provided an overview of the Amerada Hess chart. (Copy on File).

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Discussion occurred between Representative Croft and Mr. Barnhill regarding the chronology of the Amerada Hess case. Mr. Barnhill pointed out that in 1989, the Alaska Supreme Court amended the court rule, both the civil and the criminal rule that the mere receipt of a Permanent Fund dividend would not be enough to cause dismissal of a juror. That rule is still on the books. He said that signaled where the Alaska Supreme Court rests on the issue. He acknowledged that the State really does not know what would happen when a case like this comes forward.

Representative Croft interjected that there are other issues. He found it offensive that to eliminate Alaskan jurors that cannot determine things that affect an Alaskan fund because of the possibility of hidden minimal differences. The debate is attempting to make sense of that and seems as though the concern should be addressed.

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Representative Croft commented that using the money on dividend purposes would impermissibly prejudice a judge or jury because of the benefit they would receive. He asked how it could be spent on capital projects that would benefit those same judges and juries and why then could that be legal. Mr. Barnhill countered that in using the fund for capital projects, the effect could be more diffused. He suspected it had been "looted" by the Supreme Court's amendment. The only remaining issue is whether a judge was biased by receipt of a Permanent Fund dividend.

In response to further concerns voiced by Representative Croft, Mr. Barnhill advised that the case is not going to impact the Permanent Fund dividend.

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Representative Croft asked if the rule that the Supreme Court adopted on jurors would not set that type of limit, but instead states that the fact of the dividend is not sufficient to be disqualified. Mr. Barnhill responded that was correct.

Co-Chair Chenault asked about the fiscal note. He mentioned the averaged annual realized return rate of 7.61%. He asked about the bond rate versus using straight case scenario to pay for the bonding package and which option would be best for the State.

Mr. Mitchell replied it would be a policy question deciding whether to pay cash or borrow. The reasons for borrowing are rationalized through a couple different avenues. In the costs associated with borrowing money for capital projects, there exists the ability to access tax exempt markets. There is a differential between a state and municipal entity, depending on the market, it could be between 1.5% to 2.5%. The State of Alaska is exempt on the investment side as well. The State can invest in taxable investments and does not have to pay income tax on those earnings. The State can also borrow on the tax-exempt rate, where there would be a differential. There are costs depending on the issuance and complexity of the issuance to determine how expensive it might be. A general obligation (GO) bond would be inexpensive to issue. In 2003, the average underwriter spread was under \$2 dollars per 1,000 bonds.

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Mr. Mitchell advised that the flexibility would cost something but that today's rate would still be less than 5%. The 6% listed in the packet is quite conservative. He admitted that there would be some risk involved and offered to provide some number runs for the Committee. Co-Chair Chenault requested that.

Mr. Fauske related that the State has an opportunity to capitalize on the one thing that the federal government gives, the ability to issue tax-exempt debt. Over the life of these bonds, there might result between \$30 & \$50 million dollars in savings versus spending that cash. He recommended that the State take advantage of the opportunity.

Representative Hawker commended everyone who has been working on the proposal and voiced support for the conclusions. He recommended that leverage is good, as well as being a capital preservation.

Representative Hawker agreed that the proposal makes sense. He noted that the Committee is being asked to tie up the cash flow stream for some period of time. He questioned if members are comfortable with that idea. It would be a one-time solution without sustainability and inquired how it could become sustainable.

Ms. Frasca responded that the Administration does not have a proposal to address the sustainable base. She reviewed goal criteria. She noted that Representative Hawker has raised a challenge to rearrange the fund sources. At this point, there are no alternative proposals.

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Representative Hawker asked if the Administration is receptive to suggestions. Ms. Frasca replied that there is room to talk. Representative Hawker termed the possibility the "verge of a legacy concept".

Co-Chair Meyer agreed with points brought forward by Representative Hawker. Co-Chair Meyer asked about the science complex proposal assigned to the University of Alaska-Anchorage (UAA) in the amount of \$21 million dollars, first phase. Ms. Frasca replied that the Administration used the University's capital request list. In response to comments by Co-Chair Meyer regarding the road projects, Ms. Frasca admitted that the Administration is looking for alternative ways to finance the projects.

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Co-Chair Meyer referenced the letter from bond counsel and asked if that firm had anything to do with taxes. Mr. Mitchell pointed out the firm has attorneys who specialize in tax issues. Ms. Weed interjected that the firm is not speaking to the tax counsel issues but addressing financing structure concerns and the tax-exempt nature.

Representative Joule pointed out that the money that sits in the Permanent Fund is inflation proofed. He thought the proposed program would not be and asked the long-term impact of that. Ms. Frasca replied that the \$424 million dollars in the settlement account would remain that amount. It would not change. Representative Joule understood that inflation proofing would keep it at that value. He asked what the impact or loss in value could be.

Mr. Mitchell explained that the annual short term impact, inflation proofing in year one would be \$11 million dollars to qualify under the 2.6% inflation rate. The amount would reduce the transfer and for the same risk tolerance, the project list would be reduced.

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Representative Hawker referred to HB 187, the vehicle that creates the capital income account. He pointed out that it modifies existing statute to allow future legislatures to direct money for any valid public purpose. HB 188 is a bill that creates the concept. He believed that the two bills were separate concepts. He wondered if there were any restrictions in HB 187. Mr. Mitchell replied there were not.

Representative Hawker asked if it was intended to be unrestricted. Mr. Barnhill commented that it would have to be done that way to avoid the dedicated fund restriction. Representative Hawker noted that he was prepared to pass HB 187 out of Committee but not HB 188.

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Ms. Frasca was concerned about the long-term effects of separating the two bills.

Representative Kelly referred to sustainability brought up by Representative Joule and wondered if the bill could be a way to address that issue. Ms. Frasca replied that was only one piece to the capital budget.

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Representative Kelly discussed the temptation to forego achieving the sustainability for generations to come. He

added that he was counting on the House Finance Committee to inflation proof it and felt that the proposal could be improved.

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Co-Chair Meyer referenced the letter from Ms. Weed. He asked the factors which would make the bonds taxable. Ms. Weed responded that there are two ways to make the bonds taxable. One would be the type of projects funded and how those projects are used. The bonds may only be used for capital projects. You cannot use long-term debt tax-exempt bonds for ordinary operating and maintenance expense.

The second way in which bonds end up being taxable, has to do with the overall structure of the flow of the money, the types of money pledged to pay debt service and the structure on how that money is actually committed.

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Representative Hawker asked if a public entity such as the State would be exempt from spending its' assets before engaging in tax exempt financing. Ms. Weed replied that was correct. She added that they would be better off if they were not broke and had collateral to borrow money for a tax-exempt base.

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Co-Chair Meyer stated that HB 187 and HB 188 would be HELD in Committee for further consideration.

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[3:39:04 PM](#)

#### ADJOURNMENT

The meeting was adjourned at 3:39 P.M.