

**ALASKA STATE LEGISLATURE  
HOUSE STATE AFFAIRS STANDING COMMITTEE**

January 12, 2006

8:06 a.m.

**MEMBERS PRESENT**

Representative Paul Seaton, Chair  
Representative Carl Gatto, Vice Chair  
Representative Jim Elkins  
Representative Bob Lynn  
Representative Jay Ramras  
Representative Berta Gardner  
Representative Max Gruenberg

**MEMBERS ABSENT**

All members present

**OTHER LEGISLATORS PRESENT**

Representative Mike Kelly

**COMMITTEE CALENDAR**

HOUSE BILL NO. 23

"An Act relating to construction of a legislative hall."

- HEARD AND HELD

HOUSE BILL NO. 278

"An Act relating to the Alaska Municipal Bond Bank Authority; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority to assist state and municipal governmental employers by issuing bonds and other commercial paper to enable the governmental employers to prepay all or a portion of the governmental employers' shares of the unfunded accrued actuarial liabilities of retirement systems and authorizing governmental employers to contract with and to issue bonds, notes, or commercial paper to the authority or its subsidiary corporation for that purpose; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 273

"An Act relating to the dividends of individuals claiming allowable absences; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 23

SHORT TITLE: CONSTRUCTION OF LEGISLATIVE HALL

SPONSOR(S): REPRESENTATIVE(S) ROKEBERG

01/10/05	(H)	PREFILE RELEASED 12/30/04
01/10/05	(H)	READ THE FIRST TIME - REFERRALS
01/10/05	(H)	STA, FIN
03/19/05	(H)	STA AT 9:30 AM CAPITOL 106
03/19/05	(H)	<Bill Hearing Postponed>
04/23/05	(H)	STA AT 9:30 AM CAPITOL 106
04/23/05	(H)	Heard & Held
04/23/05	(H)	MINUTE(STA)
01/12/06	(H)	STA AT 8:00 AM CAPITOL 106

BILL: HB 278

SHORT TITLE: RETIREMENT SYSTEM BONDS

SPONSOR(S): REPRESENTATIVE(S) HAWKER

04/19/05	(H)	READ THE FIRST TIME - REFERRALS
04/19/05	(H)	STA, FIN
01/12/06	(H)	STA AT 8:00 AM CAPITOL 106

**WITNESS REGISTER**

REPRESENTATIVE MARK NEUMAN

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Offered information relating to HB 23.

REPRESENTATIVE NORMAN ROKEBERG

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Presented HB 23, as sponsor.

REPRESENTATIVE MIKE HAWKER

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Presented HB 278, as sponsor.

DEVEN MITCHELL, Executive Director

Alaska Municipal Bond Bank Authority ("Bond Bank")  
Juneau, Alaska

POSITION STATEMENT: Answered questions on behalf of the Bond Bank during the hearing on HB 278.

GREG SUNDBERG, Managing Director  
Merrill Lynch  
Seattle, Washington

POSITION STATEMENT: Presented information and answered questions on behalf of Merrill Lynch during the hearing on HB 278.

MARK PRUSSING, Vice President  
Seattle-Northwest Securities Corporation  
Seattle, Washington

POSITION STATEMENT: Answered questions on behalf of Seattle-Northwest Securities Corporation during the hearing on HB 278.

#### **ACTION NARRATIVE**

**CHAIR PAUL SEATON** called the House State Affairs Standing Committee meeting to order at [8:06:37 AM](#). Present at the call to order were Representatives Elkins, Lynn, Ramras, Gruenberg, and Seaton. Representative Gatto and Gardner arrived as the meeting was in progress.

#### HB 23-CONSTRUCTION OF LEGISLATIVE HALL

[8:07:59 AM](#)

CHAIR SEATON announced that the first order of business was HOUSE BILL NO. 23, "An Act relating to construction of a legislative hall."

[8:08:04 AM](#)

REPRESENTATIVE MARK NEUMAN, Alaska State Legislature, stated that through discussions with John Duffy, Manager, Matanuska-Susitna (Mat-Su) Borough, approximately 1,000 acres have been identified within that borough as available to give any developer rights to construct a legislative hall. He said he envisions hotels and shopping areas that would emerge there in what he described as the fastest growing areas in the state. He indicated that about 60 percent of the state lives nearby and approximately 75 percent of the state would have access by road to the area.

REPRESENTATIVE NEUMAN clarified that he is not proposing a move of the capital; the legislative hall would just serve as a place for the legislature to meet during its session. He said he thinks this is a good option that would not cost the state a lot of money. He noted that there is a fast ferry slated to operate next year. He said part of the bill requires that there be access to an airport. He indicated that legislators from the major population areas could go home at night, thus saving the state money in the cost of transportation. Those legislators in Southeast, Alaska, he noted would have to do the traveling that the rest of the legislators are already doing.

[8:11:07 AM](#)

REPRESENTATIVE LYNN moved to adopt the committee substitute (CS) for HB 23, Version 24-LS0164\F, Cook, 1/9/06, as a work draft. There being no objection, Version F was before the committee.

[8:11:48 AM](#)

CHAIR SEATON asked if Representative Neuman is suggesting that the developer would work within the specifications created by Legislative Council.

[8:11:57 AM](#)

REPRESENTATIVE NEUMAN answered that's correct. He said, "I think that it would assist [Legislative] Council tremendously to have a developer there to help them work through this process." He said he thinks it may save the state money and time.

[8:12:22 AM](#)

REPRESENTATIVE LYNN noted that there is a small light plane landing field there, but he said he doesn't know how close that is to "the anticipated terminus of the proposed Knik Arm Bridge on the north side which could be used."

[8:12:50 AM](#)

REPRESENTATIVE NEUMAN said he believes it's a private airstrip, but he noted that there are plans for the development of a commercial airstrip. He noted that there is natural gas and electricity in the area.

[8:13:24 AM](#)

REPRESENTATIVE LYNN said the original bill limits participation to boroughs with 30,000 residents and he suggested that would need to be changed so that the area Representative Neuman is describing could participate.

[8:13:49 AM](#)

REPRESENTATIVE NEUMAN clarified that it would be the municipality of Mat-Su Borough that would be involved.

[8:14:08 AM](#)

REPRESENTATIVE LYNN said he wondered if legislative/staff housing would be provided close to the hall. He clarified that he is describing some sort of annex that would be owned by the state.

[8:14:27 AM](#)

REPRESENTATIVE NEUMAN indicated that some type of housing units may be built; however, he noted that Anchorage is not far away.

[8:15:51 AM](#)

CHAIR SEATON clarified that the committee is not hearing a specific plan right now; Representative Neuman is just coming forward to show that there is an area interested in bidding on a legislative hall.

[8:17:05 AM](#)

REPRESENTATIVE LYNN said his idea for housing would work anywhere in the state.

[8:17:18 AM](#)

REPRESENTATIVE NEUMAN said the Mat-Su Borough would donate the land to a developer that would like to build a legislative hall, which he said would cost the state virtually nothing for the construction of the building.

[8:17:51 AM](#)

REPRESENTATIVE ELKINS said he is pleased to hear that the economic engine is working in Mat-Su, but he thinks it's inappropriate for the legislature to consider taking economic sanctions against another community.

8:19:01 AM

CHAIR SEATON asked Representative Elkins to hold that thought for the sponsor of the bill.

8:19:23 AM

REPRESENTATIVE GRUENBERG noted that the [Fiscally Responsible Alaskans Needing Knowledge (FRANK)] Initiative is repealed on page 5, Section 6 of Version F. He asked Representative Neuman if he supports the repeal of the FRANK Initiative.

8:20:20 AM

REPRESENTATIVE NEUMAN said he would like to withhold his response until he is further versed regarding Version F, but he said he would get back to Representative Gruenberg on that. In response to Representative Elkins' previous remarks, he asked that legislator to keep in mind that he believes that "it is a major calling by the majority of the state of Alaska to have access to their legislators while they're in the legislative session." He said [if a legislative hall was closer to the majority of the population], school children could visit the legislature and learn its process. He said he recognizes Representative Elkins' concern.

8:22:14 AM

REPRESENTATIVE NORMAN ROKEBERG, Alaska State Legislature, as sponsor of HB 23, referred to the sectional analysis included in the committee packet and reviewed the requirements of select sections of Version F. He said Section 2 would require Legislative Council to develop specifications by December 15, 2006, changing the term "uniform building code" to "international building code," as well as some other administrative changes. Section 3, he said, sets the [date by which the hall must be completed] to June 30, 2009. Section 4 states that Legislative Council must [select or reject] proposals by June 30, 2007. Section 5, he confirmed, would repeal the provision of the FRANK Initiative, included in AS 44.06.050, 055, and 060.

REPRESENTATIVE ROKEBERG said the FRANK Initiative requires that the public be informed in advance of all costs involved in relocating the capital or the legislature. He explained that the repeal provision was added "in order to, in a more timely

manner, proceed with the activities of the legislature and Legislative Council on this." He said it is going to be extremely difficult to meet the requirements [of the FRANK Initiative]. He said the way [HB 23] is designed, the legislature would only pay \$1 a year rent [for a legislative hall]; however, there would be other costs for relocation, for example. He said there would be other "modest costs," which he estimated would be "somewhat less than \$10 million maximum." In other words, he explained, the FRANK Initiative is not necessary under the terms of the bill.

REPRESENTATIVE ROKEBERG said the FRANK Initiative was designed by "the citizens of this fair city to protect their position as holding onto the capital." He said the attorney general (AG) found that the requirements of the initiative were that all bondable costs be part of the costs of either relocating the capital or the legislature. He said in 1982, voters rejected a ballot proposition to relocate the capital to Willow, Alaska, after the FRANK Initiative had been adopted. The estimate for that move was \$2.8 billion, which he said was an absurd figure that the people of the state naturally rejected.

[8:27:55 AM](#)

REPRESENTATIVE ROKEBERG revealed his strong background in commercial real estate development. He said it's always been his contention that a construction of a new capital could be accomplished for little or no cost to the state, because "private sector real estate developers would lust after the chance to build a new capital building." He mentioned a building in Anchorage that, for example, could be converted to a capital for under \$35 million, but he said he's not recommending that. In regard to the previous comments of Representative Elkins to Representative Neuman, he stated:

I believe in my heart of hearts that the only way we're going to get a new capitol building - and I strongly advocate that - is to have this type of competition ... throughout the state on the level playing field that everybody has a chance to make a proposal. That includes Juneau. I thoroughly believe ... that building could be in this community. I believe the people in this community would have ... a very good chance of winning that proposal. They've been reluctant to agree to the financing arrangements under this legislation; they want the legislature to pay for their new capitol building. That's the

distinction here. I think that they need to make the commitment to the legislature if they want to have a legislature here ... to pay for that building themselves - not expect us to pay the bonding rent to amortize the debt on a new structure. That's the distinction. So, the folks here in Juneau need to get off their money and prove to the people in the rest of the state that they deserve to have this legislature here. That's the issue, and that's why I'm asking that the FRANK Initiative be repealed, because it's, frankly, intellectually dishonest the way it's been used in the past to scare the people of this state.

[8:31:47 AM](#)

REPRESENTATIVE GARDNER noted that in 2002 there was an attempt to repeal the FRANK Initiative through a ballot proposition, and that attempt failed. She asked, "Does that not give us pause for repealing it legislatively?"

[8:32:15 AM](#)

REPRESENTATIVE ROKEBERG asked Representative Gardner to consider that the man in charge of that initiative dropped the ball mid-way through.

[8:33:08 AM](#)

REPRESENTATIVE GARDNER said nevertheless the initiative failed in a public vote.

[8:33:17 AM](#)

REPRESENTATIVE ELKINS said that in essence, moving the legislature would "trickle down" to moving the whole capital, because there are many support agencies in Juneau. He reminded Representative Rokeberg that former Governor Bill Sheffield moved 200 jobs to Anchorage, which crippled [Juneau] in respect to real estate until recently. He added that Ketchikan also felt the impact from the loss of the economy in Juneau.

[8:34:03 AM](#)

REPRESENTATIVE ROKEBERG replied that he tends to disagree with that analysis. First, he said Anchorage has historically had more state employees than Juneau. Regarding the historical impact, he said he questions the "economic ripple effect of

Juneau and Ketchikan." He said it's clear that the environmental lobbies and the impacts of the closure of the Tongass National Forest to timber, and the closure of the Ketchikan Pulp Mill has had negative impacts to Southeast economy. He added, "I would be the first to admit, however, that if, in fact, the ... legislature were to move out of Juneau, it would have a negative impact. I would agree with that. That's one reason I wanted to pursue just the legislative activities and not the entire capitol building."

[8:36:52 AM](#)

REPRESENTATIVE ROKEBERG referred to a letter from director of the Bureau of Education written to a United States Senator on May 3, 1890, which states that moving the capital from Sitka to Juneau would be a bad idea for many of the same arguments that still exist today. He stated his belief that what is not going to happen is to have a new capitol built in Juneau that is paid for by all the citizens of the state. He emphasized the need for a new capitol building and said he voted against the recent remodel on the House and Senate chambers because the cost was \$.75 million for an ineffective and poor design.

[8:38:46 AM](#)

CHAIR SEATON stated that impacts do occur when changes are made. He gave an example of the move of the ferry system to Ketchikan.

[8:39:53 AM](#)

REPRESENTATIVE GRUENBERG said he agrees that this capitol building is substandard. He said the repeal of the FRANK Initiative troubles him because that initiative strengthens the initiative process in the state. The public's right to know and participate in this issue is something that the people prize, he said, and repealing the initiative would "cloud the issue." Regarding Representative Rokeberg's comments about costs being lower than stated, he suggested that, in that case, more disclosure is better than less.

[8:42:04 AM](#)

REPRESENTATIVE ROKEBERG responded that philosophically that is true. Conversely, he pointed out that there have been 10 or 11 initiatives in 40 years of statehood. He said the community of Juneau rightfully does everything it can to hang on to the legislature. He stated that the people of Alaska have expressed

their will in "some of these votes" approving a new location. Furthermore, he said the Alaska State Constitution provides that the legislature can provide its own home. He said HB 23 would allow the legislature to do that through the repeal of the FRANK Initiative.

[8:43:32 AM](#)

REPRESENTATIVE GRUENBERG noted that the Alaska State Constitution also specifically provides that the people of the state can adopt initiatives, which they have done through the FRANK Initiative.

[8:44:30 AM](#)

CHAIR SEATON stated:

My understanding is that the repeal of this provision ... addresses the dollar lease to the state, whereas the FRANK Initiative would require the analysis of the total value of the land - the total cost of the buildings, even though we're not going to pay for those buildings - we're not going to pay for that land, but that would be the bondable cost of the capitol .... I think that this is what Representative Rokeberg was talking about was the bondable cost of a building that we're not building actually gives us a false picture of what we're doing. And the FRANK Initiative was based on us building a new capitol.

[8:45:24 AM](#)

REPRESENTATIVE GRUENBERG directed attention to AS 44.06.055, which read as follows:

Sec. 44.06.055. Relocation expenditures.  
State money may be expended to relocate physically the capital or the legislature from the present location only after a majority of those voting in a statewide election have approved a bond issue that includes all bondable costs to the state of the relocation of a functional state legislature or capital to the new site over the twelve-year period following such approval. The commission established in AS 44.06.060 shall determine all bondable costs and total costs including, but not limited to, the costs of moving personnel and offices to the relocation site; the

social, economic, and environmental costs to the present and relocation sites; and the costs to the state of planning, building, furnishing, using, and financing facilities at least equal to those provided by the present capital city.

REPRESENTATIVE GRUENBERG said the only thing that has to be given to the voters in a referendum under the FRANK Initiative is "the bondable issue." If, in fact, there are not state bonds, he observed, then the FRANK Initiative "would not require that the voters approve it." He added, "So, we should not repeal it." He said the question in his mind is whether the FRANK Initiative would apply to the deal. If it does not, he reasoned, then it does not have to be repealed. He concluded, "That just clouds the issue."

8:46:18 AM

REPRESENTATIVE ROKEBERG noted that there is an attorney general's opinion that drove the issue pertaining to the definition of all bondable costs. He stated his understanding of that opinion is that "anything that could be bonded was to be part of the dollar amount."

REPRESENTATIVE GRUENBERG said his interpretation is that that means "bondable costs to the state, not the citizens of Juneau."

REPRESENTATIVE ROKEBERG responded, "It doesn't say that, and that's how the AG's opinion is."

8:47:07 AM

CHAIR SEATON said this is a question that needs to be resolved, and he asked Representative Rokeberg to get the AG's opinion to the committee.

8:47:30 AM

REPRESENTATIVE ELKINS asked if the state would be required to underwrite any of the bonds.

8:47:45 AM

REPRESENTATIVE ROKEBERG answered no, not the way HB 23 is drafted. He noted that he recently had served on the committee for capitol planning at the request of Juneau's Mayor Bruce Bothello. The cost of that proposal, under the FRANK

Initiative, should have gone on the ballot for the approval of the public.

[8:48:56 AM](#)

CHAIR SEATON, after ascertaining that there was no one to testify, closed public testimony. In response to a request from Representative Gardner, he said he would reopen public testimony at a later date for anyone who just received the committee substitute and wishes to testify.

[8:50:19 AM](#)

REPRESENTATIVE GRUENBERG said whether the capital is ultimately moved "under the rest of the bill" is a potential issue, whereas the repeal of the FRANK Initiative would occur immediately; therefore, he said he agrees with Representative Gardner that there may be people who want to testify.

[8:51:14 AM](#)

CHAIR SEATON stated his interest in obtaining an opinion from Legislative Legal and Research Services regarding the applicability of bonding.

[8:51:44 AM](#)

REPRESENTATIVE GRUENBERG asked that someone from the Office of the Attorney General be prepared to testify.

[8:52:05 AM](#)

CHAIR SEATON announced that HB 23 was heard and held.

HB 278-RETIREMENT SYSTEM BONDS

[8:52:41 AM](#)

CHAIR SEATON announced that the next order of business was HOUSE BILL NO. 278, "An Act relating to the Alaska Municipal Bond Bank Authority; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority to assist state and municipal governmental employers by issuing bonds and other commercial paper to enable the governmental employers to prepay all or a portion of the governmental employers' shares of the unfunded accrued actuarial liabilities of retirement systems and authorizing governmental employers to contract with and to issue

bonds, notes, or commercial paper to the authority or its subsidiary corporation for that purpose; and providing for an effective date."

[8:52:59 AM](#)

REPRESENTATIVE MIKE HAWKER, Alaska State Legislature, as sponsor of HB 278, said in the first half of the Twenty-Third Alaska State Legislature much time was spent discussing the state's pension funds, which are underfunded. He said almost every public entity in America is facing similar circumstances. He said it is the responsibility of the legislature to find a way to pay off that obligation in the most expedient manner and with the least possible costs to the taxpayers of the state. He told the committee that he is presenting a high-level, broad discussion of a vehicle that could allow the state to pay off that liability. He said that the amount of the liability is approximately \$6 billion. All the public employers that pay into those plans owe that money, he explained. He said the state does not have a bank account with \$6 billion in it to use to pay off that liability.

[8:56:41 AM](#)

REPRESENTATIVE HAWKER reviewed that that liability accrues interest each year at about 8.25 percent. He said the crux of the bill is paying off the liability or a portion thereof immediately, getting money into the system to start [earning interest]. He said if the state could find a way to borrow the money for 5 percent, for example, the state would, over time, save 3 percent while paying off the debt. He indicated that that is what a pension obligation bond (POB) would do, and he said HB 278 would be the vehicle to allow participants in the retirement plan to investigate the possibility of using POBs. He said if the state executes such a transaction the potential exists of saving the taxpayers of Alaska \$1.5 billion.

[8:59:33 AM](#)

REPRESENTATIVE HAWKER turned to the sponsor statement and reviewed the three components of the bill, which read as follows [original punctuation provided]:

HB 278 authorizes the Alaska Municipal Bond Authority to consider issuing pension obligation bonds (POBs) at the request of the state or a municipal governmental employer. POBs are a proven and acceptable tool to

manage pre-existing liabilities for state and local pensions. Bond market participants are receptive to POBs, including bond insurers, rating agencies and investors.

HB 278 expands the authority of the Alaska Municipal Bond Authority to support the state or a municipality that wishes to include POBs in their strategy to reduce the cost of meeting unfunded pension liabilities.

This bill does not authorize any debt instruments to be issued. The state or a municipality would need to take a separate specific action to utilize this new ability of the Municipal Bond Bank Authority.

REPRESENTATIVE HAWKER referred to a handout included in the committee packet, entitled, "An Introduction to Pension Obligation Bonds." He noted that the document was prepared by Roger Davis of Orrick. He encouraged the committee members to review the document, stating his belief that doing so would give them a comprehensive understanding of the pros and cons that must be considered. He said Orrick is an experienced, professional bond counseling firm. Attached to the same handout are two written "what if" discussions - one from Merrill Lynch and one from UBS Financial Services, Inc. He noted that also included in the paperwork are research papers provided from Standard & Poor's (S&P) - a bond rating agency, entitled: "POBs surging after brief hiatus"; "Managing State Pension Liabilities - A Growing Credit Concern"; "U.S. Public Pensions Face Uncertain Times"; and "Pension Obligation Bonds - Were They A Good Bet?" The last item in the package of information, he noted, is a resolution from the Alaska Municipal League (AML) asking that the authority be granted for public employees in Alaska to consider "these financing vehicles."

[9:05:20 AM](#)

REPRESENTATIVE HAWKER directed attention to page 8 of the Orrick report, which shows that the POBs are better than the alternatives, which are: to pay more into the pension fund; to ask employees to pay more into the pension fund; to reduce benefits; or to do nothing and hope the gain on investments will ultimately solve the problem. He noted that the disadvantages are listed on page 9 of the Orrick report. He said the state could write a check for \$6 billion out of the constitutional budget reserve (CBR), the earnings of the permanent fund, and

this year's surplus, but he doesn't see that as a viable alternative. He said he sees the mechanism [that HB 278 would allow] as less objectionable as a means of mitigating the state's cost than writing that check and taking every penny the state has off the table.

REPRESENTATIVE HAWKER said some will warn that POBs will injure the state's credit rating. He directed attention to page 13 of the Orrick report, which includes extracts of rating agency comments about the concept of using pension obligation bonds to reduce the ultimate cost of satisfying the pension obligation. He said the rating agencies essentially endorse the concept. The comments generally say that a properly structured transaction is endorsed and would potentially enhance the state's credit rating, because the state would be taking positive, proactive steps, recognized and acceptable to Wall Street, to address the existing large, unfunded obligation.

REPRESENTATIVE HAWKER noted that Moody's Investors Service, Standard & Poor's, Fitch, Inc., and [Duff &] Phelps are the major rating agencies. He pointed to the comment on page 13 written by Fitch, Inc., which read as follows:

Fitch believes that POBs, if used moderately and in conjunction with a prudent approach to investing the proceeds and other pension assets, can be a useful tool in asset-liability management.

REPRESENTATIVE HAWKER said the key is the word "moderately." He said anyone who has ever lost money investing in the stock market understands that it is possible to lose money in a financial transaction.

[9:11:02 AM](#)

REPRESENTATIVE HAWKER said some will say a constitutional issue may exist. He said, "Our constitution has a provision that basically, on the surface, says the state can only borrow money for capital development projects." He stated that it is possible to structure transactions that comply with that constitutional guideline. He said the Merrill Lynch company addresses constitutional issues and a "legal structuring that would comply with" the Alaska State Constitution. He proffered that if the legislature grants the authority, there are smart lawyers and investment bankers that will be able to work with the public employers of the state to create transactions that will be constitutionally sound. He asked committee members to

not close their minds to something that has the potential of saving the taxpayers of Alaska \$1.5 billion or more.

[9:13:14 AM](#)

REPRESENTATIVE HAWKER stated that the entire decision in considering POBs revolves around the risk and reward trade off. He said he wants to empower public employers and the competent professionals they would work with to propose specific financing structures for consideration by the appropriate authoritative body. That body would assess the risks and find a structure within a risk tolerance level. The easiest thing for public employees to do, he said, is to not make a decision that entails risk. The private sector, on the other hand, takes calculated risks. Representative Hawker said the public sector needs to "take a lesson" from and merge with the private sector. He reminded the committee that HB 278 is not about making the decision about what risk will be tolerated or what specific mechanism of approach to use; it is simply a bill that authorizes public employers across the state, the investment banks, and the legal community to get together and bring to the appropriate authority a proposal to evaluate.

[9:16:37 AM](#)

REPRESENTATIVE HAWKER stated, "The ultimate control is in the evaluation of a specific transaction, but we can't even look at the specific transaction until we, as a legislative body, allow people to think out of the box." He asked the committee not to get bogged down in the details of any possible transaction.

[9:17:53 AM](#)

CHAIR SEATON asked where in the bill it is written that the public entity would come back to the legislature.

[9:18:26 AM](#)

REPRESENTATIVE HAWKER answered that each entity would go through its particular authority. For example, the school district would go through the school board. He said, "Specifically, this grants the ... Bond Bank [the] authority to set up the structure to facilitate these transactions."

CHAIR SEATON responded:

Right, I just want to clarify that, because I thought I heard you saying that they would come back to us with proposals. But really ... this bill actually authorizes them to develop and go through their public process to issue pension obligation bonds.

REPRESENTATIVE HAWKER interjected, "Or to undertake such a transaction."

[9:19:29 AM](#)

REPRESENTATIVE GARDNER expressed her appreciation in Representative Hawker's bringing the bill forward. She said that sometimes the state's public liability for the pension system is compared to a mortgage. However, she said if she were to buy a \$200,000 house, she would know exactly what the debt is, and she would have full use of the entire value of that home during the time she owns it. The pension liability is not concrete, she noted. She stated her understanding that the state has enough money in its accounts to pay for "everything that falls due today." She surmised that the problem is "out into the future." She asked if that is correct.

[9:20:52 AM](#)

REPRESENTATIVE HAWKER said there is a lot of money in the pension funds today. There is also an obligation that the funds in the bank today must satisfy in the future. The calculation shows that, over time, there is not enough wealth in the fund to meet the obligations that exist today. Doing nothing, he explained, would result in less money in the pool to earn the compound interest that is factored into meeting the total obligations and, thus, in a "more expensive solution." Using a mortgage analysis, he said if a person makes a large principal payment up front, that payment is reduced, with less to pay in the long run. He said the situation is similar for the state. He said, "We would have more money in the pot to invest, so we get a greater investment return."

[9:23:23 AM](#)

CHAIR SEATON stated as a reminder that three quarters of the money paying those obligations comes from investment earnings. He said:

For every dollar we don't have in the bank now, it takes basically \$4 in the future. ... You're not

just underfunding a dollar. ... The 75 percent that that dollar is supposed to earn to pay those obligations isn't going to be there, because it hasn't been in there earning from the present dollar to the obligation dollar.

[9:24:31 AM](#)

REPRESENTATIVE GARDNER concluded that that's a missed opportunity cost. She clarified her previous question. She noted that an interest of 8.25 percent had been mentioned. She asked, "Where does that come in? Are we already paying interest on what we don't have for the future?"

[9:24:48 AM](#)

REPRESENTATIVE HAWKER explained that all the actuarial evaluations are predicated on: "We put money in, and when the money's there it makes 8-plus percent. If the money's not there, it's not making the 8-plus percent and we're getting deeper in the hole every day."

[9:25:38 AM](#)

CHAIR SEATON remarked that there is a sort of reverse action that exists. He explained that if the state calculated that it would only be earning 5 percent, instead of 8.25 percent, then the current obligation, instead of being approximately \$6 billion, would be \$10-12 billion. He offered further details.

[9:27:03 AM](#)

REPRESENTATIVE HAWKER said the POB solution is not a short-term fix, but works only because of averages in the market over time. He cited the 10-year returns for the following: PERS investments at 8.1 percent; TRS at 8.2 percent; and the Alaska Permanent Fund Corporation at 8.7 percent. He said the State of Alaska has had extraordinary amounts of money to invest in the capital markets of the world and has developed proven investment structures through the use of successful management. He said an 8 percent return is "achievable, valid, and a parameter that we don't have to question in this analysis."

[9:29:43 AM](#)

REPRESENTATIVE GRUENBERG offered questions that need to be asked: The first question is whether the state should do

anything. The next question is whether the state should use POBs and, if so, whether the Bond Bank should be used. He noted that Representative Hawker has chosen the Bond Bank to be the issuing authority. He stated his understanding that the Bond Bank typically issues bonds for municipalities and the bill would significantly expand its authority. He asked Representative Hawker to comment.

[9:31:04 AM](#)

REPRESENTATIVE HAWKER deferred to representatives from Merrill Lynch. He proffered that the use of the Alaska Municipal Bond Bank Authority ("Bond Bank") as part of structuring a transaction is constitutionally acceptable. It is a facility that has a lot of competent, qualified professionals for "issuing debt."

[9:32:14 AM](#)

REPRESENTATIVE GRUENBERG said he would like that question answered in the future. He noted that the final paragraph of the sponsor statement read: "This bill does not authorize any debt instruments to be issued." He said it appears to him that the text of the bill does exactly that.

[9:33:12 AM](#)

REPRESENTATIVE HAWKER clarified that the bill authorizes transactions to occur, but it does not authorize any specific transaction.

[9:34:14 AM](#)

REPRESENTATIVE GRUENBERG said Representative Hawker has alluded to certain constitutional issues. Traditionally, if there are constitutional issues in a bill, that bill is heard by the House Judiciary Standing Committee. He said he is interested in solving those issues in the House State Affairs Standing Committee for the sake of expediency.

[9:35:02 AM](#)

REPRESENTATIVE MIKE KELLY, Alaska State Legislature, said the bill would offer municipalities some choice in their own destiny and "some level of acceptance of risk." Regarding the previous comparison to a mortgage, he suggested using that comparison, but adding things into it such as the cost of fuel and

electricity, which may double along the way, and an uninsured risk. He explained that Representative Hawker's situation is that he is trying to estimate what the total cost of 25 years paying off an obligation is, but there are a lot of variables along the way. He stated that there is a great misunderstanding regarding the 8.25 percent.

[9:38:35 AM](#)

CHAIR SEATON asked, "Where does the state come in ... to back up that bond for that municipality that we're authorizing in the bill to go forward and issue a debt instrument?"

[9:39:22 AM](#)

REPRESENTATIVE HAWKER responded that the question of who is obligated would be determined by the terms and conditions of the bond indenture itself. He emphasized that the state would not accrue any new liability; the state would just be allowing employers to pursue and choose transactions.

[9:40:17 AM](#)

REPRESENTATIVE KELLY noted that "last year" a conversation took place with Mr. Boutin regarding the possibility of involving the state "in some fashion that would probably lower the cost and increase the delta between 8.25 percent and some (indisc. -- coughing) number, which is what this would attempt to do." He asked if the bill addresses some of what Mr. Boutin was talking about.

[9:41:04 AM](#)

REPRESENTATIVE HAWKER replied that he is not familiar with what was discussed, but he remarked that the less risk on a loan that the lender perceives, the lower the rates that can be executed. He reminded the committee that that level of detail is not the focus of this discussion; the legislature just needs to decide whether to allow the markets to "go forward and ... work."

[9:42:27 AM](#)

CHAIR SEATON surmised that Representative Kelly wants to know if there is an alternative to having the state bonding authority do the work. He said there may be an alternative, but that would require an amendment to the bill.

9:43:01 AM

REPRESENTATIVE HAWKER asked the committee to remember that the bill would not force anyone to take a risk, but would allow all the different public employers to make their own risk determinations.

9:44:01 AM

DEVEN MITCHELL, Executive Director, Alaska Municipal Bond Bank Authority ("Bond Bank"), disclosed that he is also the Debt Manager for the Treasury Division, within the Department of Revenue. Mr. Mitchell reviewed that the Bond Bank is a public corporation of the State of Alaska that was created in 1976. He said the reason for its creation was because at that time, generally all communities in Alaska were penalized in the capital market because of the perception of Alaska as a Third World country. He said there was "an Alaskan penalty when we went to market," and [the Bond Bank] "offered an opportunity to create a more efficient means of access in the capital markets for Alaskan communities." Over the last five years, he noted, the Bond Bank has issued approximately \$4 million in bonds for loans to 52 different projects. He offered examples.

MR. MITCHELL said he thinks the reason that the Bond Bank was selected for inclusion in HB 278 is because of the role the Bond Bank currently plays with municipal entities in helping them finance their capital needs in an efficient manner. He said there is a "state support to the Bond Bank," which is called a moral obligation of the State of Alaska. In the statutes that create the Bond Bank there are provisions for the creation of a reserve fund. That reserve fund, he noted, is essentially the equivalent of one year's debt service of all of the Bond Bank's bonds. He explained that when the Bond Bank borrows money, it issues bonds in the capital markets; it takes that money and lends it to the communities at the same rates at which it borrowed the money. All the Bond Bank's bonds in its general obligation program, he said, are issued on a parity basis, meaning that "they have the same plane on assets and revenues as other bonds in the reserve fund." He said the Bond Bank has an approximately \$30 million reserve fund that secures the bonds. Mr. Mitchell stated that if there was a draw on that reserve fund because one of the communities defaulted, in all but one case the reserve would fully pay for that community's debt service, "and so that creates part of the credit of the bond bank." He added, "But if there were a draw on that reserve because of a community default, we would be ... required by the

statute to request the legislature and the governor to appropriate money to replenish that reserve. That is the moral obligation; the requirement that we request the replenishment implies that we would receive the replenishment in the moral obligations."

[9:47:39 AM](#)

CHAIR SEATON asked if there is any distinction between the security backing a general obligation bond and the POBs if they were issued through [the Bond Bank].

[9:47:54 AM](#)

MR. MITCHELL noted that there is a revenue bond program in the Bond Bank that relies on specific enterprise credit strength. He said, "So, this would maybe be more similar to that in the structure as proposed." He noted that there are some questions about the structure and "the implementation of that; how that would be managed." He said Representative Hawker, in his testimony, alluded to a proposal that contemplates the possible use of a revenue bond structure, and there is some disagreement in the legal community regarding whether or not that would be allowed. He advised the committee of the need for discussion on additional issues to ensure that the proper structure would be in place to meet certain expectations.

[9:49:26 AM](#)

CHAIR SEATON asked if Mr. Mitchell was suggesting that the committee should resolve that question before it authorizes issuance of the bonds.

[9:49:50 AM](#)

MR. MITCHELL said that issue should be resolved sooner rather than later. He spoke of finding middle ground. He continued:

... In Oregon they actually ... [dealt] with a similar issue. I don't know all the nuances of it, but in the end they wound up having a constitutional amendment to allow general obligation pledges of local districts for this type of obligation, which our constitution prohibits at this point because there's no capital project.

And the [difficulty] with revenue bonds is there's not an enterprise; it's a contractual promise to pay that exists to the pension system. If you want your participants to receive the pensions that were promised to them, you have to pay. Whether or not that can be transferred then to a bond issue is a difficult question to answer, I think, even amongst attorneys.

[9:51:18 AM](#)

CHAIR SEATON encouraged Mr. Mitchell to continue to share his knowledge with the committee as the hearings on HB 278 progress.

MR. MITCHELL, in response to a request from Representative Gruenberg, agreed to supply the committee with a thorough description of who he is and what he does.

[9:52:03 AM](#)

REPRESENTATIVE GRUENBERG told Mr. Mitchell that if he believes there is a constitutional issue, he would like to see a legal opinion and a draft constitutional amendment.

[9:53:23 AM](#)

MR. MITCHELL said he has not seen a legal opinion. He revealed that he is involved in a transaction that will close in February [2006], involving five communities and five bond councils, in addition to the bond council with which he works. He said during casual conversations there have been a variety of opinions expressed. He said he thinks Representative Gruenberg is asking for something much more formal, and he recommended an opinion be obtained from the Office of the Attorney General. In response to Chair Seaton, he offered to request that opinion.

[9:54:33 AM](#)

REPRESENTATIVE GRUENBERG stated that he wants the legislature to be on good legal ground.

[9:56:04 AM](#)

GREG SUNDBERG, Managing Director, Merrill Lynch, noted that he had brought with him a handout [included in the committee packet] entitled, "Presentation to: State of Alaska: PERS/TRS Update Pension Obligation Bonds January 2006." He said it would

take 2.5 hours to make the presentation in depth; therefore he suggested that he could simply answer questions from the committee. He also provided a list entitled, "Municipal Taxable Pension Financings 2001-Present" [included in the committee packet], which he said contains similar information to what Representative Hawker included in his previously reviewed handout. In response to a question from Representative Gruenberg, he confirmed that there is also a handout entitled, "Alaska School Districts and Municipal Governments Re: TRS and PERS Liability Refinancing," which was already in the committee packet from a prior hearing in 2005.

9:59:00 AM

MR. SUNDBERG stated that POBs are but one piece of the puzzle. He said the much harder work is that which the legislature has already undertaken to solve the systemic problem. He said Merrill Lynch has addressed the liability that has increased over the years and "stands at an actuarial-assessed number as of the current day." He said Representative Gardner indicated accurately previously that that's a number that can shift over time. He indicated that the number will probably never get to zero, but it could diminish or increase. He said the tool that is being proposed for consideration is one step in the process.

10:00:24 AM

CHAIR SEATON directed attention to page 2 of the update, and defined some terms used: "UAL" means unamortized actuarial liability and "PV" means present value. He turned to page 1, which shows the PERS/TRS unfunded liability as of June 30, 2004. He noted that the liability has been steadily increasing. By July 2005, the total liability was \$6.0 billion, and by July 2006, he said it will be \$6.5 billion. He said, "Those numbers are not changing; those are the same numbers, but it's just that we're a year later and we haven't had 8.25 percent interest on that present value deposit, and so the number's still the same." If nothing happens as far as contributions into the system by July 2007, he warned, that obligation will be \$7.1 billion. He added that that would be without any changes; "that's just because of not having another year of money in the bank accumulating interest."

10:03:27 AM

MR. SUNDBERG confirmed that Chair Seaton's statements are absolutely accurate.

10:03:33 AM

CHAIR SEATON, in response to a question from Representative Gruenberg, said the source of the numbers came from the actuarial firm Mercer Human Resource Consulting.

10:04:18 AM

MR. SUNDBERG said those who work in the debt markets tend not to distinguish in terms of the legal framework surrounding debt or contractual obligations. He continued:

We look at an obligation that you're being charged 8.25 percent on, based on an actuarial determination of the appropriate rate that you'll need to both invest at. And there's some component of that that's going to be interest; there's some component that's going to be principal - exactly like your mortgage. And that's a rate that's necessary in order for you to compound to satisfy your future obligation of this unfunded liability. So, contrast that with a world where ..., instead of compounding that 8.25 percent, you could ... pay a rate equal to what your cost of borrowing those funds is.

Again, looking at one obligation versus another: whether you have a contractual obligation to make those payments on a year-to-year basis or whether you have a contractual obligation to make debt service payments, the obligation itself is in essence the same. The result is markedly different, because in the bond world - at least as afforded in current markets and as indicated by Representative Hawker earlier - the rate right now falls somewhere between probably 5.5 and 6.5 percent. So, markedly lower than the actuarial yield you'd be charged.

The number that Representative Hawker referred to earlier, which is the present value or ... current dollars, ... that difference is roughly somewhere around \$1 billion .... That in a nutshell is really the simple mechanics of what we're talking about here.

10:07:00 AM

MR. SUNDBERG said he would now distinguish between the debt or bond side of the equation and the investment side. He continued:

Not wrapped up in the bond side is the prospect of what you do with the money once you have borrowed it. ... Instead of just paying a payment based on an interest rate of 8.25 percent per year, in a bond world it is a requirement that you actually invest the money. So, one thing that you need to do from your standpoint - a due diligence standpoint - is make sure you have a vehicle in place that you're comfortable with from an investment perspective. And, by all accounts and by all observation, you, in fact, do have that. You certainly have something that would satisfy the requirements of the rating agencies that Representative Hawker referred to earlier - Standard & Poor's, Moody's, and Fitch - as affording a high level of confidence that you were going to have an entity that was investing in a prudent fashion. That is completely separate from the bond side, and the tool that we're proposing as a potential piece of the puzzle does not incorporate a strategy for the investment of funds or a necessary component for the investment of funds. It's completely separate.

The committee took an at-ease from [10:08:29 AM](#) to [10:16:59 AM](#).

[10:17:29 AM](#)

MR. SUNDBERG suggested the easiest way to look at [changing to a POB structure] is changing "one mortgage obligation for another mortgage obligation." He said virtually every municipal entity is well accustomed to refinancing its debt from a higher interest rate to a lower one. He continued:

And what you do when that process is undertaken is that you structure a new bond issue at a lower cost that has cash flows that are on a pro rata basis proportionate to your previous payments, but in fact lower, because it's a lower interest rate. And that's another useful tool, I think, in terms of using bonds versus your existing contractual obligation for an unfunded liability at 8.25 percent.

[10:18:47 AM](#)

REPRESENTATIVE GRUENBERG asked if there are other kinds of financing that the committee should consider allowing under HB 278. He asked if there are variables or other kinds of securities that would prevent the necessity of underwriting new bonds every time the interest rate changes.

[10:19:26 AM](#)

MR. SUNDBERG said he is referring to bonds in a generic sense. He explained that within the framework of bonds there are a number of different structural features that can be incorporated.

[10:19:50 AM](#)

REPRESENTATIVE GRUENBERG clarified that he wants to ensure that the words being used would allow even the most conservative bond lawyer to "do what you're saying." He said he would like Mr. Sundberg to return with an answer.

[10:20:15 AM](#)

REPRESENTATIVE HAWKER noted that the language of the bill does not refer to bonds, per se; therefore, it is constructed to provide access to the widest variety of financial instruments available on the street.

[10:20:37 AM](#)

CHAIR SEATON directed attention to page 23 of the update, the "Oregon Example," which shows results for the City of Portland. He noted that the City of Portland used a combination of fixed and variable rate debt. Historically, he said, the cost of variable rate debt has been significantly below the cost of fixed rate debt. The risk of variable rate debt is that rates spike up. He said it could be conservatively argued that a straight fixed rate program offers more assurance and certainty.

[10:22:59 AM](#)

MR. SUNDBERG, in response to a comment by Chair Seaton, proffered that the variable rate does afford the additional benefit of being redeemable at any time. In response to a question from Chair Seaton, he said long-term obligations typically have a redemption provision for calling the debt back in and restructuring it. Inside of 10 years - based on the call date on the bonds - the obligations could be advance refunded.

Outside of 10 years, he said, there is the same flexibility as with variable rate obligations.

[10:24:15 AM](#)

MR. SUNDBERG, in response to a follow-up question from Chair Seaton, said the market has evolved to the point where there are a lot of obligations - particularly in the tax-exempt realm, where there's not a premium charged for "redemption of bonds early." He concluded, "In the taxable world - which these obligations would be taxable - there is more often a redemption premium inside that 10 years."

[10:24:32 AM](#)

MR. SUNDBERG, in response to a question from Representative Gruenberg, said there are entities in various jurisdictions in the U.S. who have "looked for ways to do these on [a] tax exempt basis." He said the federal government tends to frown on ways for the state to benefit at the expense of the federal government. He said, "In our way of thinking and in the foreseeable future, we see these as always taxable obligations."

REPRESENTATIVE GRUENBERG asked, "What is the criterion for determining whether an obligation issued by a state or local government or an entity like the Bond Bank Authority would be tax exempt versus non-tax exempt? What's the bright line criterion that the [Internal Revenue Service (IRS)] uses?"

MR. SUNDBERG answered that it varies by entity and by type of purpose to which the monies will be applied. He said, "But as a general rule, in this instance what we're dealing with is a situation where the federal government frowns on the ability of a local ... or ... state jurisdiction to be able to borrow money at a tax-exempt rate and reinvest it at a taxable rate. There are very limited circumstances where you can do that, and that would tend to be the bright line."

[10:26:51 AM](#)

CHAIR SEATON said he would like to pose that question to the Alaska Municipal Bond Bank Authority at a future date, in order to get an answer from a state perspective.

[10:27:20 AM](#)

MR. SUNDBERG recalled another issue that had been addressed was in regard to the type of vehicle that would be used to fund a bond obligation within the state of Alaska. Mr. Sundberg said that although he is not an attorney, he works in a world that intersects with bond attorneys every day. He continued:

... We try to have a nexus where we come up with an idea and we match that to existing laws, best as possible, and if there are requirements to tweak or change the law, we tweak or change the law to the extent that it is desirable on the part of the benefiting entity. We try to, at all costs, avoid things that would require constitutional change, because that's something that's probably the most difficult to achieve.

So, ... when we first started looking at this issue, we were looking at it on the basis of individual municipal jurisdictions - not looking at it on a statewide basis necessarily or the state specifically. We ... immediately came to the conclusion that it would be very difficult to do this under Alaska constitutional law; that ... a general obligation - which is the least expensive way of borrowing - ... would run afoul of the constitution.

MR. SUNDBERG said Merrill Lynch considered whom an experienced entity would be that could serve as a conduit or as an issuing entity for the contractual obligations that the municipal entities have built up. He stated that the Bond Bank has a long history of providing funding for municipal jurisdictions. He said thus far the issue of whether the state itself could solve or address its unfunded liability through the use of the Bond Bank has not been discussed. That, he said, is a question that attorneys need to wrestle with further. What has been questioned is whether there is a precedent for municipal entities coming individually to the Bond Bank for the issuance of debt, and the answer is yes.

MR. SUNDBERG said, "We jumped then from general obligation issues to two ... different types of bond issues based on the revenue stream that's used to repay the debt. One of those would be appropriation debt." He said [Merrill Lynch] looked at the possibility of structuring an obligation that was subject to annual appropriation and questioned whether that would be covered under the umbrella of a general obligation. He said the response received from a number of attorneys is that it would

not be covered; it would be considered to be a separate obligation and one, in fact, that could be issued.

MR. SUNDBERG said another question, primary to the use of the Bond Bank, is whether there are obligations that could be structured as contractual obligations. He offered the example of a funding that he personally has been involved in is that of the Federal Bureau of Investigation (FBI) headquarters in Anchorage. He explained that the FBI building is secured by contractual payments from the U.S. General Services Administration (GSA) that flow through an intermediate entity. He added, "And that's ... what would be more referred to as a contract obligation, as opposed to a general obligation. So, we looked at that as another vehicle, and again one that we felt would make the attorneys more comfortable looking at the constitution restrictions and looking at the available mechanisms that might be used to secure an obligation as a means of selling debt.

MR. SUNDBERG explained that once the attorneys give the okay, the flip side of the coin is having to question: "Is this something we could sell into the market? Would investors buy it?" He clarified that the question of whether or not bond council will provide an opinion is separate from the question of whether there will be a market for these obligations at a desirable rate. He concluded, "And we feel in the case of both the contract obligation model, as well as the appropriation model, that structurally we can get to something that has a lot of investor appeal."

[10:31:58 AM](#)

MR. SUNDBERG, in response to a question from Chair Seaton, said a contract obligation is very similar to a revenue bond obligation. He offered the example that an individual municipal entity that comes to the Bond Bank has a "cumulated contractual obligation" to make payments into the pension obligation, and instead of making those payments on an annual basis into the pension fund, that funding would be provided up front by the issuance of bonds and the municipal entity would instead be making contractual payments to bond holders.

CHAIR SEATON stated his understanding that Mr. Sundberg was separating out the past service cost from the normal service cost. The latter, he noted, would still be paid by the municipality into PERS.

MR. SUNDBERG said that's correct.

REPRESENTATIVE GRUENBERG recalled that there was a bill passed last year that provided for a type of alternative funding that was contractual.

[10:33:28 AM](#)

CHAIR SEATON confirmed [with information shared by Mr. Mitchell off microphone] that the bill had to do with a virology lab that dealt with structured payments from the Department of Administration.

[10:34:23 AM](#)

MR. SUNDBERG said he would conclude that the vehicle that was used was "referred in our lexicon as a certificate of participation."

[10:34:38 AM](#)

REPRESENTATIVE GRUENBERG said yes.

[10:34:43 AM](#)

MR. SUNDBERG said, "That particular obligation does ... bear a great resemblance to what you are doing with what I refer to as, sort of, middle-ground type obligation that you could construct under [HB] 278."

[10:34:55 AM](#)

REPRESENTATIVE GRUENBERG referred to part of Article 9, Section 8, of the Alaska State Constitution, which read:

No state debt shall be contracted unless authorized by law for capital improvements or unless authorized by law for housing loans for veterans, and ratified by a majority of the qualified voters of the State who vote on the question.

He suggested that the legislature should look at whether that provision is out of date and the state should be provided with more flexibility.

[10:36:16 AM](#)

MR. SUNDBERG said there is a two-stage check on the entire process: First, the bill does not replace or circumvent the existing jurisdiction's process for issuing bonds. No one will be getting blanket authorization. The bill just adds the potential to use a tool if it is viewed as a prudent part of an overall package, with regard to the balance of state and municipal obligations as well as market conditions. Second, each individual entity would have to go through a serious review by the rating agencies. He continued:

Rating agencies have generally become quite comfortable with this as a tool. In fact, they've become more comfortable with the tool than entities that are trying to get along without it. They view the obligations in the same way we do - that it's a contractual obligation you have to fund on an annual basis. And their question is very similar to mine: "Do you do it at [an] 8.25 percent interest rate, or do you do it at a lower market rate?" They do not necessarily penalize you for not using this tool, but they certainly don't penalize you for using it when it's combined with a prudent investment practice. And the key is "prudent investment of proceeds."

[10:39:28 AM](#)

CHAIR SEATON directed attention to page 5 of the update, which explains pension financing. He noted [that the chart showing "taxable pension bond financings"] shows that the number of financings in 2003 was approximately 70, but it dropped to less than 60 in 2004 and to less than 40 in 2005. He asked what the reason is for that fairly rapid decline.

[10:40:29 AM](#)

MR. SUNDBERG responded that much like a lot of sectors of the market, the issuance of pension obligations tends to be a somewhat "lumpy" proposition. He reminded the committee that the chart shows the number of financings rather than the dollar amount of financings; therefore, the dollar volume may have increased while the number of financings decreased. In response to a follow-up question from Chair Seaton, he noted that there was a dip in interest rates in 2003, which corresponded with an increase in financing. He concluded, "If we remain at or near the level of interest rates that we are experiencing right now, we would anticipate that based on the growing problem, and this being more and more accepted as a good tool to address the

problem, ... you'll see more financings done - in terms of dollar amount."

[10:43:18 AM](#)

MARK PRUSSING, Vice President, Seattle-Northwest Securities Corporation, said that the corporation is the leading underwriter of municipal bonds and financial advisory work in the Northwest and is the financial advisor to the State of Washington and the City & Borough of Juneau. In response to a request from Chair Seaton, he explained that underwriting bonds means buying the bonds and turning around and selling them to investors, thereby taking the risk of finding the buyers for those bonds. He stated that he and Mr. Sundberg are competitors in their everyday business; however, "in this effort we are joining forces in that we both have an interest ... in providing a framework for the State of Alaska to issue pension obligation bonds." The nature of each one of those individual obligations will vary, he said.

MR. PRUSSING revealed that he has had 25 years of public finance experience - a substantial amount of that in Alaska. He offered further credentials. He said he was involved in the initiation of the Alaska State Pension Investment Board and "served the staff" to that board for a number of years. He said he currently works in municipal finance and underwrites bond issues.

[10:46:14 AM](#)

MR. PRUSSING, in response to a request for clarification from Representative Gruenberg, said he is speaking today as both a potential financial advisor and a potential underwriter. He said his information today is meant to be shared as "informational in nature" rather than as any obligation his corporation has with the State of Alaska or municipal entity.

[10:47:24 AM](#)

MR. PRUSSING said the Seattle-Northwest Securities Corporation thinks the Bond Bank could provide a broader ability for smaller municipal entities to enter the capital markets "that others would not be able to." He said the corporation sees many parallels between Oregon and Alaska. He noted that in one case the Oregon School Board Association formed its own entity to issue bonds with a trustee. He said that would be similar to if the Alaska Municipal League decided to pool municipalities

together. He said the Bond Bank is not the only vehicle, but the corporation thinks it would be a good one, especially if it were the intent of the legislature to provide some additional security for the bonds that were issued through the Bond Bank. He said he doesn't think that's what's anticipated currently, but it could be added on if it were the goal of the legislature to reduce the borrowing cost of the entities that issue bonds through the Bond Bank.

MR. PRUSSING continued as follows:

For example, you could put into place a stronger ability to intercept revenues to a school district or municipality that the money goes to the Bond Bank to make that debt payment first. Doing that would allow an entity to put that pledge in place, and it allows investors then greater security that they're going to receive their money before the operations -- they're the first handout, if you will, when money comes in. And this would particularly play a role in the TRS system where the majority of funding from school districts comes from the state. Putting an intercept in place to intercept that money first before it goes to the school districts to pay the debt service on these bonds, would increase investor acceptance. And what that means is it would provide a lower interest rate on that pension obligation bond. And ... rather than having that liability accruing at 8.25 percent, having it accrue at a lower rate would actually result in more of the money that you send to the school districts being put to use in education and in the classrooms. So, we think that if you choose to use the Bond Bank, ... it would be a good vehicle to add on some abilities, if that's what you choose to do. We think that, of course, the stronger credit quality that you can provide, the lower the borrowing cost would be; but it is a legislative decision on how much the state wants to stand in to help the municipalities.

[10:50:18 AM](#)

MR. PRUSSING, in response to a question from Chair Seaton, said the information he had just discussed can be found on page 13 of his handout [entitled, "Pension Obligation Bonds," included in the committee packet]. He continued:

And this is something that you could do without really putting the state behind the debt - say for ... any of the school districts that pool together. You wouldn't be saying that if they default ... you would step in and make that payment. But what you would be saying is that you would provide the Bond Bank the authority to intercept the money going through the district to make the debt payments.

CHAIR SEATON, regarding the term "intercept," asked if Mr. Prussing is talking about the PERS payment that is coming from the school district based on the contribution rate.

MR. PRUSSING answered no. He clarified, "We're talking about ... the money that the state pays to the school district to support its operations. ... A portion of that could be intercepted in between the state and the school district to make the payment on the bonds through the Bond Bank." In response to a question from Representative Gruenberg, he confirmed that he is talking about foundation formula money.

[10:53:22 AM](#)

CHAIR SEATON asked if that would be the portion of the foundation formula money that is related to the salary base of teachers that make the contribution to PERS.

[10:53:49 AM](#)

MR. PRUSSING answered that the goal would be to provide bondholders more assurance that the district is going to make its payment on the bond. He said, "To the extent that you can intercept any funds before [they] get to the hands of the ... school district ... and send [those funds] to bond holders provides greater assurance to the bond holders that they're going to receive their money." He emphasized that he offered the previous remarks as an example, not a proposal.

[10:55:46 AM](#)

REPRESENTATIVE HAWKER, in response to a concern stated by Chair Seaton, said he thinks the committee is focused on the specifics when it should have been a more general commentary. He said, "The interest on the debt will be lower if there is less risk to the lender. All that we're really discussing in this point is ... a possibility of a way the state itself may, as a policy decision, decide to lower the risk to the lender of the money."

He spoke of a municipal revenue sharing program as possibly being another source. There are any number of technical devices that could be considered; however, the bill is only the framework to "make this happen." He said it might be best to consider vehicles that might specifically aid in an execution when they are specifically identified, "rather than trying to create a generic catchall that might open up or might cause some unanticipated consequences."

[10:57:36 AM](#)

MR. PRUSSING agreed with the comments of Representative Hawker. He said the state later could consider a constitutional amendment that would allow a municipality to issue general obligation bonds to fund pension obligation bonds.

[10:58:13 AM](#)

REPRESENTATIVE GARDNER asked Mr. Prussing if he knows of any advisors who would be likely to advise against POBs.

[10:58:47 AM](#)

MR. PRUSSING recalled that within the Department of Revenue there is an opinion that POBs should be entered into cautiously. He said his corporation would agree with that assessment. He said it is important to analyze the risk of any financing that is undertaken. He said:

And in this case the risk is: "Will you earn more than you're paying on the bonds?" If you ... borrow money and put it into an investment vehicle, and if you do not earn at least what you're paying on those bonds, you would have been better off not doing that.

MR. PRUSSING said the State of Oregon conducted a statistical analysis in 2003 and came up with the conclusion that there was a 90 percent probability of exceeding the bond interest rate with their investment earnings. He stated that any investment vehicle has tradeoffs. The leaders in Oregon that moved for incorporating POBs were the school districts and municipalities; initially the state was opposed to issuing POBs. He offered further details. He stated that Alaska would not be cutting new ground; however, the legal framework of the state is different. He said his corporation plans on working with the Alaska Retirement and Management Board to look at the nuts and bolts of the system to ensure that the money that is put in can be

appropriately accounted for and the entity receives the appropriate benefit. He said each governmental entity has its own process for approving debt, whether it's a municipal entity, or the state. If the state were to do something on its liability, that is something that could be addressed through HB 278, or through a constitutional amendment. He said it's important to distinguish between the state's liability and what it wants to do with it versus the municipalities' liabilities and what each wants to do with them. He concluded, "This legislation, essentially, while it may eventually be used for the state, [is] mainly geared, as I believe, to allow the municipalities to work with their legislative bodies to determine whether this is an appropriate vehicle for their finances."

[11:03:30 AM](#)

REPRESENTATIVE GRUENBERG asked Mr. Prussing what kind of constitutional amendment was necessary in Oregon.

[11:03:46 AM](#)

MR. PRUSSING said Oregon could not legally issue bonds. In response to a follow-up question from Representative Gruenberg, he said his corporation would provide the committee with further information in that regard. He also noted that he has asked legal counsel to draft what a constitutional amendment would look like for Alaska. He offered to work with Mr. Mitchell to provide that.

[HB 278 was heard and held.]

#### **ADJOURNMENT**

There being no further business before the committee, the House State Affairs Standing Committee meeting was adjourned at [11:04:06 AM](#).