

SENATE FINANCE COMMITTEE  
February 29, 2008  
9:07 a.m.

CALL TO ORDER

Co-Chair Hoffman called the Senate Finance Committee meeting to order at [9:07:59 AM](#).

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair  
Senator Bert Stedman, Co-Chair  
Senator Charlie Huggins, Vice-Chair  
Senator Kim Elton  
Senator Donny Olson  
Senator Joe Thomas  
Senator Fred Dyson

MEMBERS ABSENT

None

ALSO PRESENT

Representative Mike Hawker; Amanda Ryder, Fiscal Analyst, Legislative Finance; Brian Andrews, Deputy Commissioner, Treasury Division, Department of Revenue; Adam Stoll, Vice President, Goldman Sachs; Greg Sundberg, Managing Director, Merrill Lynch

PRESENT VIA TELECONFERENCE

Jeff Urbina, Vice President, Wachovia Securities, Seattle; Carol Samuels, Senior Vice President, Seattle Northwest Securities, Oregon

SUMMARY

SB 256 "An Act making supplemental appropriations, capital appropriations, reappropriations, and other appropriations; amending certain appropriations; ratifying certain expenditures; making appropriations to capitalize funds; and providing for an effective date."

SB 256 was heard and HELD in Committee for further consideration.

CSHB 13(FIN)

"An Act relating to prepayments of accrued actuarial liabilities of government retirement systems; relating to the Alaska Municipal Bond Bank Authority, the Alaska Housing Finance

Corporation, and the state bond committee; establishing the Alaska Pension Obligation Bond Corporation; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance Corporation, the state bond committee, and the Alaska Pension Obligation Bond Corporation to assist state and municipal governmental employers by issuing bonds, notes, commercial paper, or other obligations 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; authorizing a governmental employer to issue obligations to prepay all or a portion of the governmental employer's shares of the unfunded accrued actuarial liabilities of retirement systems and to enter into a lease or other contractual agreement with a trustee, the Alaska Municipal Bond Bank Authority or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance Corporation, the state bond committee, or the Alaska Pension Obligation Bond Corporation in connection with the issuance of obligations for that purpose, and relating to those obligations; relating to revision of the employer contribution rate in connection with financed prepayment of unfunded accrued actuarial liabilities of government retirement systems; and providing for an effective date."

CSHB 13 (FIN) was heard and HELD in Committee for further consideration.

SB 229 "An Act relating to the Tanana Valley State Forest and to assignment of certain forest land to the Minto Flats State Game Refuge; and providing for an effective date."

SB 229 was scheduled but not heard.

[9:08:20 AM](#)

SENATE BILL NO. 256

"An Act making supplemental appropriations, capital appropriations, reappropriations, and other appropriations; amending certain appropriations; ratifying certain expenditures; making appropriations to capitalize funds; and providing for an effective date."

Co-Chair Hoffman noted it was the third hearing on SB 256 by the Senate Finance Committee.

9:11:09 AM

TIM GRUSSENDORF, STAFF, CO-CHAIR LYMAN HOFFMAN, turned to page 7 of the supplemental requests spreadsheet for CSSB 256 (FIN) to explain modifications and additions that have been made:

Sections 7-9    Natural Resources    Oil & Gas

Cost to implement ch.1, SSSLA 2007 (HB 2001) Alaska's Clear and Equitable Share legislation. Add two Oil & Gas Revenue Audit Master exempt positions. The amount is reduced from the original fiscal note due to later than anticipated hiring of the positions. The FY09 budget contains a related increase of \$303.5.

Mr. Grussendorf explained that the number was reduced from \$110,000 to \$85,000 due to positions not yet hired.

Sections 7-9    Public Safety    Judicial Services - Anchorage

Assume Anchorage prisoner transport duties. Assumes December 2007 hire date for six new positions. Covers one-time purchases and share of annual expenses. If one-time costs are not funded here, additional funds will be needed in FY09. In the FY09 budget at \$656.3 for a full year's costs, but that does not include one-time costs.

Mr. Grussendorf related that the reduction from \$620,300 to \$477,600 is because the new positions have not been hired yet.

Section 13(a)    Environmental Conservation    Water Quality

Implementation of the Ocean Ranger program. The contract needs to be established early enough to allow the contractor to hire and train Ocean Rangers prior to the season beginning in May 2008. The contractor will incur substantial expenditures for hiring, training, and purchasing equipment in preparation for the upcoming season. In addition to the contractor's costs, the department is incurring expenditures for paying staff and other expenditures for implementation of the program.

Mr. Grussendorf reported that the language was modified to clarify that the program spends no more than the \$4 berth tax that it generates.

Section 22    Education School Performance Incentive Program

If the amount necessary to pay school performance incentives exceeds the amount appropriated for FY08, the additional amount necessary is appropriated. The department won't know the final amount until after the legislature has adjourned. Similar language is included in the FY09 operating budget.

Mr. Grussendorf explained that the Governor had proposed a three-year line for the performance incentive program. An additional \$1.4 million will be funded for the program and allow a report to be generated to see if the program is working as expected.

[9:13:47 AM](#)

Section 27 Debt Fund Capitalization PCE Fund

Increase PCE Fund capitalization by \$700.0 from \$12,999.4 GF to \$13,699.4 GF (total funds from \$25,273.0 to \$25,973.0) in order to provide more PCE funding needed due to increased fuel costs.

Mr. Grussendorf explained that the number was changed from \$700,000 to \$1.2 million for FY 08, and the FY 09 request would be reduced by \$500,000 in order to fully fund PCE for FY 08.

Mr. Grussendorf reported on a new appropriation of \$13,261,000 to Retirement & Benefits that will depend on the passage of SB 125, which is the PERS/TRS bill. It will be a one-time payment for the "heroes list" and those who were under the rate of 22 percent. If SB 125 passes, the language regarding the "phase up" to 22 percent will be removed.

[9:15:16 AM](#)

Mr. Grussendorf reported on a new appropriation to Commerce regarding QTA Independent Travelers Grants. All non-Vehicle Rental Tax funds will be replaced with Vehicle Rental Tax funding. The Vehicle Rental Tax will be placed into the Department of Natural Resources, Parks Management.

Mr. Grussendorf related that there would be a new appropriation of \$150 million for the capitalization of the new fund for revenue sharing to Commerce, Revenue Sharing, contingent on the passage of SB 72.

Mr. Grussendorf explained a new appropriation to Fish and Game for the Anchorage Hatchery. It is a scope change that removes language enabling funding to be spent on a hatchery in Fairbanks (leaving a hatchery for Anchorage in the appropriation language).

Mr. Grussendorf said that there is a new Fund Capitalization to the Statutory Budget Reserve which appropriates \$1 billion of the FY 08 surplus to the SBR.

Mr. Grussendorf reported another new Fund Capitalization to the Constitutional Budget Reserve of an appropriation of \$2.6 billion of the Fy08 surplus to the CBR.

Mr. Grussendorf explained a language change in the Department of Revenue, Shared Taxes and Fees, which would add shared taxes and fees language for revenue collected in FY 08, remove the commercial passenger vessel excise tax from FY 09's budget, and not include it in the FY 08 supplemental to ensure that the correct persons receive the payment.

[9:18:04 AM](#)

Mr. Grussendorf related that a new appropriation of \$200 million to the Department of Revenue, Alaska Housing Finance Corporation (AHFC), is part of a new energy program called the Alaska Housing Energy Efficiency and Weatherization Program. Another appropriation of \$100 million is part of the new Alaska Housing Home Energy Rating Rebate Program.

Mr. Grussendorf noted that there is a new placeholder of \$50 million for the Department of Transportation and Public Facilities, for capital projects.

Mr. Grussendorf reported on an appropriation of \$68 million to the Department of Administration for capital in order to replace the Master Lease Line of Credit Funding with general funds. This will reduce the FY 09 budget by \$4 million (reduction in debt service payments) and will add \$68 million to the supplemental: \$10 m (SATS/ALMR), \$41 m (AKPAY), \$17 m (phone system).

[9:19:34 AM](#)

Mr. Grussendorf highlighted the total projects that were deleted and approved, and the amount the Senate Finance Committee has added, including supplemental savings.

#### Section 26 (f) Transportation

The Environmental Protection Agency (EPA) has initiated an enforcement action against DOT&PF, alleging multiple violations of the Clean Water Act. In addition, EPA is requesting information regarding sand and gravel sources. EPA believes that DOT&PF and its contractors have been operating material sites without appropriate storm water permits.

The EPA has proposed settling the case if the State

agrees to the entry of a consent decree(s) that could involve the payment of significant fines (Idaho and Hawaii have paid fines between \$500,000 and \$1,000,000), be required to conduct supplemental environmental projects, and provide training within DOT&PF.

This funding would be used to collect evidence, present a defense and begin negotiating a settlement. It is anticipated that costs are expected to be at least \$500.0 during calendar year 2008 so an extended lapse date through June 30, 2009 is requested.

AMANDA RYDER, FISCAL ANALYST, LEGISLATIVE FINANCE, explained that the modification was because of EPA's enforcement action and the money would be used for legal action. The money was appropriated to enable the state to pay settlement costs.

[9:21:31 AM](#)

Co-Chair Stedman MOVED to ADOPT the CS for SB 256, labeled 25-GS2009\C, Kane, 2/29/08.

Co-Chair Hoffman OBJECTED for discussion purposes.

Co-Chair Hoffman commented that the original bill was for approximately \$205 million and the committee is approving \$172,816,800 in the new version of the bill. There is an increase in general funds of \$4,150,730,800. The vast majority of this appropriation is savings of \$2.6 billion to the CBR, a payment of 50 percent of the outstanding balance, leaving a balance of \$2.6 billion. The CBR currently has a balance of \$3.3 billion and the addition of \$2.6 billion would bring the fund balance to \$5.9 billion. If this trend continues, it is conceivable that the CBR could be completely paid off in a few years.

[9:24:09 AM](#)

Co-Chair Hoffman continued to explain that a deposit of \$1 billion to the SBR requires only a simple majority. Also included in the fast track supplemental is \$18.5 billion needed to ensure that the senior services legislation recently passed gets funded. He noted that \$300 million is set aside for grants for energy assistance. Another major change is \$150 million for revenue sharing, contingent on passage of SB 72.

[9:26:17 AM](#)

Co-Chair Stedman clarified that \$3.6 billion is being put into savings, \$300 million into energy conservation, and \$150 million into revenue sharing. Co-Chair Hoffman

commented that the bill front-end loads the revenue sharing program that will ensure the life of a \$50 million program each year. Co-Chair Stedman continued to explain that there is also, \$18.5 million for Senior Care in the bill. He added that there was also a \$50 million place holder for dealing with capital appropriations which were vetoed by the Administration. Those will be flushed out in the next few days.

Co-Chair Hoffman emphasized that Alaskans are concerned about not spending the entire surplus; therefore, the committee is proposing to set aside \$3.6 billion in savings. Alaskans are concerned about energy costs and this bill is a first step to ensure that Alaskans can take the initiative to weatherize their homes. He termed the bill a major increase to what the Administration has proposed and a major step in the right direction.

[9:29:15 AM](#)

Senator Thomas inquired about the appropriation regarding the Anchorage hatchery. He shared his understanding that there was an agreement based on bond funding paid by license fees. He noted that cost overruns contributed to the decision to have only one hatchery. He questioned why the Fairbanks hatchery was removed from the funding. He did not approve of the approach. He suggested splitting the money equally between Fairbanks and Anchorage.

Co-Chair Hoffman thought there would be further debate on the issue.

Senator Dyson requested a review of the vetoed capital budget items.

Co-Chair Stedman recalled that the Administration vetoed over \$100 million in the capital budget last year. He thought there was lack of information and miscommunication which led to the items being vetoed. The list is being reviewed with a target range of about \$50 million. He noted that there is no intent to put all of the vetoed items on the table. He hoped that additional savings would be forthcoming during this budget cycle. He mentioned that there are also social issues that need to be addressed.

[9:34:57 AM](#)

Senator Dyson wondered if some of the vetoed projects would be put back into the supplemental budget. Co-Chair Stedman called it a work in progress.

Senator Dyson took that as a maybe. He emphasized that the current supplemental document does not contain any vetoed projects. He voiced concern about mixing budget items

across the fiscal year barrier and mixing capital and operating items.

Co-Chair Hoffman recalled that that practice has been around for a long time.

AT EASE: [9:37:33 AM](#)

RECONVENED: [9:38:13 AM](#)

Co-Chair Hoffman pointed out that in this budget process, fiscal years are not being crossed. Co-Chair Stedman pointed out that there is a \$50 million place holder in the bill and the vetoed items have not been listed in the bill yet. He commented that during the last two years an attempt to add transparency was made. He explained that there may be problems, but care must be taken when looking at the supplemental budget to look at operating impacts, and not to get caught up in the dollar amounts. He urged committee members to concentrate on looking at the impact to the agencies in order to achieve an accurate budget and the smallest supplemental budget possible. The goal is to have all of FY 09 funded out of FY 09 funds, plus savings.

Senator Dyson summarized that the \$50 million is a place holder for vetoed capital projects. Co-Chair Hoffman concurred.

[9:41:42 AM](#)

Co-Chair Hoffman noted his intent to expedite the supplemental budget. He summarized that the total savings in the bill are in excess of \$11.5 billion.

Co-Chair Stedman agreed if the earnings reserve account is removed, the total is about \$7 billion. The operating account is about \$4 billion. He concluded that these are huge steps forward.

There being NO OBJECTION CSSB 256 (FIN) was adopted.

AT EASE: [9:43:55 AM](#)

RECONVENED: [9:47:12 AM](#)

Co-Chair Stedman brought the meeting back to order.

[9:48:33 AM](#)

CS FOR HOUSE BILL NO. 13(FIN)

"An Act relating to prepayments of accrued actuarial liabilities of government retirement systems; relating to the Alaska Municipal Bond Bank Authority, the Alaska

Housing Finance Corporation, and the state bond committee; establishing the Alaska Pension Obligation Bond Corporation; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance Corporation, the state bond committee, and the Alaska Pension Obligation Bond Corporation to assist state and municipal governmental employers by issuing bonds, notes, commercial paper, or other obligations 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; authorizing a governmental employer to issue obligations to prepay all or a portion of the governmental employer's shares of the unfunded accrued actuarial liabilities of retirement systems and to enter into a lease or other contractual agreement with a trustee, the Alaska Municipal Bond Bank Authority or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance Corporation, the state bond committee, or the Alaska Pension Obligation Bond Corporation in connection with the issuance of obligations for that purpose, and relating to those obligations; relating to revision of the employer contribution rate in connection with financed prepayment of unfunded accrued actuarial liabilities of government retirement systems; and providing for an effective date."

REPRESENTATIVE MIKE HAWKER, SPONSOR, related that HB 13 would authorize the state to engage in pension financing transactions in order to fully fund the state's pension liabilities.

[9:50:09 AM](#)

BRIAN ANDREWS, DEPUTY COMMISSIONER, TREASURY DIVISION, DEPARTMENT OF REVENUE, reviewed a past presentation on Pension Obligation Bonds (POB's) which covered reasons to issue the bonds, what risks are involved, the potential saving that may be achieved, and why POB's are taxable debt, not tax-exempt debt.

Mr. Andrews pointed out that the mechanics of a POB transaction are relatively simple. A POB transaction tries to accomplish the replacement of an existing debt obligation with another form of debt which has a lower cost. The concept is the same as refinancing a home mortgage at a lower interest rate.

The 2006 actuarial report points out that the state has an \$8.6 billion unfunded liability (debt) that it owes to the state pension plan. It carries a cost of 8.25 percent. Two weeks ago pricing from three major investment banking

institutions was obtained. A POB transaction deal could be done for 5.25 percent, a savings that over 25 years on a billion dollars represents \$23 million a year or \$323 million over 25 years discounted at 5 percent.

Mr. Andrews reported that the debt markets currently are exhibiting a lot of instability. He voiced confidence, though, that a transaction could be accomplished between 5.25 percent and 5.75 percent. The interest rate environment is the lowest it has been in the past 40 years. In fact, the ten year treasury at about 3.7 percent has only been lower 3.9 percent of the time in the past 20 years. The secret to a POB transaction is to do it at the lowest possible cost.

Mr. Andrews explained that if the proceeds of a POB transaction are invested with an earnings rate greater than the cost, it is a good deal. Over the past 16 years, in only 2 years, 2001 and 2002, the issuance of a POB transaction would have proven to be a poor decision. This is a 25 year transaction, so it will not be known if it was a good or bad deal until the POB is paid off.

[9:53:25 AM](#)

Mr. Andrews addressed the political and market risks. He turned to the PERS Case Study savings matrix on page 27 from his previous handout entitled, "Pension Obligation Bonds, February 8, 2008". He pointed out the annual contribution rate of 35 percent in PERS - an average of all participants. He showed how the various bond transactions affect contribution rates and savings. He explained that the matrix is unique because it also shows the impact of cash on the contribution rate. The point is that cash is the best asset to use. He added that a 5.25 percent cost of debt was used and the matrix was based on a level percent of pay.

Mr. Andrews pointed out the conclusions on page 31. As long as more can be earned than the cost of the POB, it is a better move. It is a very favorable interest rate environment. Risks associated with POB issuance are quantifiable and statistically justified by the rewards. Doing nothing is not a viable option.

[9:57:23 AM](#)

Senator Dyson stated his understanding about pension obligation bonds. He requested information about how the market uses taxable and non-taxable bonds. He wondered if bonds should be issued for construction projects, rather than for debts.

Mr. Andrews spoke of IRS rules which prevent the use of an earnings arbitrage. He explained how they are marketed at a

higher rate. He talked about tax exempt strategies which have higher risk. The capital projects amounts are not sufficient enough to do a \$2 billion-plus deal.

Senator Dyson said that investors and managers of the funds are attracted to tax exempt bonds. He suggested bonding capital projects to pay down PERS/TRS liability. Mr. Andrews explained that the state cannot take money and use it for unfunded liability and qualify for a tax free exemption.

Co-Chair Stedman added that the state already has the ability to issue bonds for capital projects. He gave an example. He requested comments on that possibility. Mr. Andrews explained that it is fine as long as there is not a physical connection. If the capital projects are bonded, which frees up money in the budget, then that money can be used to pay down the unfunded liability.

Co-Chair Stedman said it is a policy decision.

[10:03:42 AM](#)

Representative Hawker added that as large and diverse as the state is, there is a role for both tax exempt debt for specific projects and for debt specifically targeted for reduction of the pension liability. He pointed out that a balanced program, which is currently in place, is the best.

Co-Chair Stedman requested information about how the bonds are rated and issued. Mr. Andrews explained that that state currently has an AA rating - a neutral rating. An increase to AA1 was requested recently. POV's are appropriation bonds and the ratings are one notch below other state ratings - AA minus.

Co-Chair Stedman asked about expectations of the issuance of \$1 billion at today's market at AA minus - an estimate in dollars. He mentioned the \$3.6 billion in savings and a desire to push the state's rating higher and thereby reducing the pension debt somewhat.

[10:08:51 AM](#)

Senator Dyson asked what an appropriate level of debt for the state to carry is. Mr. Andrews commented that Alaska is very unique compared to other states. Tools rating agencies use to measure other states don't apply to Alaska because of its dependence on oil for revenue. POB transaction does not impact the state's rating. He said the state has an additional capacity for general obligation debt of about \$1.5 billion.

AT EASE: [10:11:23 AM](#)

RECONVENE: [10:12:08 AM](#)

Senator Dyson said he is interested in what the prudent level of debt the state can carry is, knowing that the \$40 billion is off limits. Co-Chair Hoffman thought the committee should be interested in the answer.

Representative Hawker referred to hangouts from the previous meeting: Pension Obligation Bonds and Other Post-Employment Benefits by Roger Davis and published by Orrick, and "Time May Be Ripe For A POB Revival" by Standard & Poor (copies on file.) He maintained, in the context of the bill, the rating agencies do not view POB's as adding to state debt. Structuring a method to pay off debt can enhance the state's rating.

Co-Chair Stedman referred to a cash flow analysis sheet from February 15. He requested additional columns be added to show the payments assumed under SB 125.

Senator Thomas said he is surprised at the adjustment that has to be made over the 25-year time period for the net present value of savings. Mr. Andrews noted that reflects money's time value.

[10:16:35 AM](#)

JEFF URBINA, VICE PRESIDENT, WACHOVIA SECURITIES, SEATTLE, reported that Wachovia Securities was the number one ranked underwriter for municipal bonds in Alaska for 2007. He shared the history of his company's involvement with pension obligation bonds. He reported that there are only a few tools to use to address an unfunded pension liability. It is difficult to compare Alaska to other states. Most POB programs focus on a three-legged stool approach: programmatic evaluation, actuarial assumption analysis, and an evaluation of actuarial investment pool earnings. This approach frames a solution to unfunded pension liabilities. Most solutions include POB's. Mr. Urbina summarized that he feels that Alaska would be successful using POB's.

[10:20:32 AM](#)

CAROL SAMUELS, SENIOR VICE PRESIDENT, SEATTLE NORTHWEST SECURITIES, OREGON, shared Oregon's experience with bond issuance. Oregon's system is about four times the size of Alaska. At the end of 2002, there was an estimate of the unfunded liability totaling \$17 billion. The state provided legislative changes in 2003, which reduced unfunded liability by about 50 percent. Voters approved the issuance of \$2 billion in state bonds. In addition, local governments issued \$3 billion in bonds. The results have been very positive. The rate of return was at 8 percent.

It was estimated that savings would be about 25 percent or \$1.4 billion. The highest rate of return was over 20 percent. She related the advantages of the long-term successes of the bonds. She emphasized that it is important to structure the financing carefully and have an understanding as to how bond proceeds will be invested.

Co-Chair Stedman referred to a handout from the Seattle Northwest Securities company (copy on file.)

[10:25:44 AM](#)

ADAM STOLL, VICE PRESIDENT, GOLDMAN SACHS, referred to a presentation in the members' packets. He related that POB's are a very common tool used by governments. Since 2003 there have been over \$30 billion in POB's issuances. Last month a Standard & Poor report said POB's have been popular with issuers and successful for sponsors. He mentioned the current low interest rate environment and its advantages to Alaska.

Mr. Stoll referred to page 2 of the handout which depicts three examples of past POB's: Oregon, Illinois, New Jersey. He noted that the interest costs of the three plans vary greatly. He explained the advantage of an investment rate of return on POV's issued with a low interest cost.

Senator Thomas noticed an extreme amount of activity in 2002-2005, as depicted on page 1. Mr. Stoll said that was due to unfunded liabilities increasing greatly during those years because of low returns.

[10:28:59 AM](#)

GREG SUNDBERG, MANAGING DIRECTOR, MERRILL LYNCH, reported that his company has worked on this legislation with a variety of people in Alaska for the past four years. He thought the legislation was a good tool and he spoke in favor of the bill. He offered to answer questions.

Representative Hawker summarized that the legislation is a prudent measure for the state to undertake.

Co-Chair Stedman suggested working with the Department of Revenue to expand the cash flow analysis. Representative Hawker agreed.

SENATE BILL NO. 229

"An Act relating to the Tanana Valley State Forest and to assignment of certain forest land to the Minto Flats State Game Refuge; and providing for an effective date."

SB 229 was scheduled but not heard.

ADJOURNMENT

The meeting was adjourned at 10:31 AM.