

SENATE FINANCE COMMITTEE
February 5, 2010
9:10 a.m.

[9:10:05 AM](#)

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:10 a.m.

MEMBERS PRESENT

Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice-Chair
Senator Johnny Ellis
Senator Dennis Egan
Senator Donny Olson
Senator Joe Thomas

MEMBERS ABSENT

Senator Lyman Hoffman, Co-Chair

ALSO PRESENT

Deven Mitchell, Executive Director, Alaska Municipal Bond Bank Authority, Department of Revenue; Jerry Burnett, Deputy Commissioner, Division of Treasury, Department of Revenue.

SUMMARY

^Overview of State bonding and debt instruments

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Co-Chair Stedman explained that the committee is considering policy decisions regarding cash payment for infrastructure investments versus issuing debts. This year the committee is reviewing a proposal from the governor to use certificates of participation for the State Crime Lab and the University of Alaska Fairbanks (UAF) Life Sciences Building. He expected to learn more today about the certificates of participation along with other debt instruments. He pointed out a version of "Alaska's Public Debt" (Copy on File), a primary source of information about state obligations.

Co-Chair Stedman expected a review from the Department of Revenue (DOR) and the Department of Legislative Finance on the categories of public debt and bonding provisions contained in the American Recovery and Reinvestment Act (ARRA).

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DEVEN MITCHELL, EXECUTIVE DIRECTOR, ALASKA MUNICIPAL BOND BANK AUTHORITY, DEPARTMENT OF REVENUE, highlighted the PowerPoint presentation "Information for Senate Finance Committee presented by: the Alaska Department of Revenue" (Copy on file).

Mr. Mitchell reviewed Slide 2: "Discussion Agenda"

- State Debt Discussion
- Bond Structuring Opportunities from Recovery Act
- Current Market Condition
- Summary

Mr. Mitchell continued with Slide 3: "\$9.3 Billion in Outstanding State Debt"

▪ General Obligation	502.8
▪ State Supported	1349.8
▪ State Guaranteed	383.9
▪ State Moral Obligation	1250.0
▪ State Revenue	639.5
▪ University	128.0
▪ State Agency	744.4
▪ State Agency Collateralized	2698.0
▪ Municipal	3297.9

Mr. Mitchell referenced the "Alaska Public Debt" book Page 5, Table 1.1 (Copy on File). He began with state debt, in particular the General Obligation (GO) Bonds, which include a state credit pledge. He informed that outstanding obligations total \$502.8 million. An additional \$150 million was authorized in 2008 for transportation projects not yet been issued. State supported debt is a category subject to appropriation. Lease purchase financings are certificates of participation, which yield based on the market conditions of the day. The state reimbursement of Municipal School Debt Service is classified as GO debt of state municipalities and equals \$920 million. State reimbursement of capital projects relates to HB 528 and has a current outstanding balance.

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Co-Chair Stedman pointed to the table on Page 5 of the debt book. He noted that the table contained subcategories.

Mr. Mitchell continued with Lease Revenue Bonds, which are subject to appropriation, when a fractionalized leased facility is involved. State Guaranteed Debt is a state obligation akin to GO. He mentioned a bill intended to provide additional authorization for the state guaranteed

debt. The debt is also collateralized by the mortgages entered into with veterans. The program has some of the lowest default rates of any mortgage program in Alaska.

Mr. Mitchell continued with State Moral Obligation Debt, which is a category of debt with statutory requirement that a reserve be funded. The reserve is a security feature on the bonds. A failure to pay debt service results in the provision of a one year grace period. The reserve must be established and the legislature must be requested for replenishment in the event of a draw on the reserve. The construct implies that the legislature would appropriate in the event of default. The category also contains the Alaska Municipal Bond Bank, the Alaska General Authority, and the Alaska Student Loan Revenue Bonds.

Mr. Mitchell continued with the State Revenue Debt. The state has a prohibition on dedicating revenue excluding a dedication prior to statehood or federal mandate. The Sport Fish Revenue Bonds were a means of relying on the federal mandate to dedicate all revenue related to sport fishing. The International Airport Revenue Bonds existed prior to statehood under the same category.

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Co-Chair Stedman asked for clarification on International Airport Revenue Bonds. Mr. Mitchell responded that the Alaska International Airport System existed prior to statehood, leading to exemption from prohibition on dedicated revenue. The sale of revenue bonds requires a contract to pledge revenues. A limited number of opportunities exist to sell bonds at the state level. The university system includes revenue bonds with \$128 million outstanding. State Agency Debt is secured by the public corporations pledge. He mentioned the northern tobacco securitization corporation, which has \$387.4 in bonds outstanding. The reason that the revenue was securitized was to avoid risk of settlement failure. The investors who purchased the bonds took on the risk and were compensated through interest rates that were greater than those subject to appropriation debt. The total State Agency Debt equals \$744.4 million including some housing corporation debt, bond bank obligations, and the Alaska Railroad.

Mr. Mitchell continued with state agency collateralized or insured debt including Alaska Housing Finance Corporation (AHFC) programs, the Shettisham Hydro Project, the revolving fund and the refunding revolving fund bonds totaling \$2.7 billion. He addressed municipal debt including the school GO debt, which equals \$1.3 billion. He identified \$1.1 billion for other GO debt and \$1.7 billion for revenue debt. The total Alaska public debt equals \$9.3 billion.

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Co-Chair Stedman requested commentary on the \$9.3 billion debt. Mr. Mitchell responded that as the state's debt manager, the focus is on general fund obligations. He informed that the School Debt Reimbursement Program should not necessarily count against the state's debt capacity. The documents from OMB and the Legislative Finance Division will not contain agency debt or collateralized debt because those are obligations that are paid from sources issuing the debt without state appropriations.

Senator Thomas requested a reason the "total debt service to maturity" was not calculated for School GO Debt, Other GO Debt, and Revenue Debt. Mr. Mitchell responded that he could certainly provide the aggregate totals, but informed that he does not receive municipal level amortizations.

Senator Thomas wondered about the case of principal outstanding interest to maturity. He asked if the bonded debt would be paid off over a period of time. Mr. Mitchell answered that much state debt carries longer maturities. He remembered a period of time when the focus was on ten year amortizations. With the sale of bonds, investors expect a certainty that they will receive an interest rate close to the market of the day. The standard call provision is ten years, which is a zero cost call for debt. He provided an example with the GO bond category where the 2003 maturity had 10, 15, and 20 year amortizations for different uses within the \$450 million authorization so the 15 and 20 year bonds are callable in 2013. Advance refunding on tax refund debt is a possibility, but it requires interest expense until the call date.

Senator Thomas asked whether a portion of the total University debt at \$128 million was repaid with general fund dollars or with the help of the University.

Mr. Mitchell responded that some state supported obligations once existed, but currently the obligations are paid out of the operating revenues of the university.

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Co-Chair Stedman stated that details about the university and their debt could be answered during the committee meeting addressing the University's operating budget.

Mr. Mitchell addressed Slide 4: "Historical Use of General Obligation Bonds." He outlined the categories and amounts issued.

Mr. Mitchell discussed Slide 5: "Subject to Appropriation Leases Since 1990" identifying the types of buildings funded

under the certificate of participation program and lease revenue conduit.

Co-Chair Stedman requested a definition for certificate of participation. Mr. Mitchell responded that a certificate of participation is a lease in which the state provides a title position to a trustee to act on behalf of the certificate purchasers. The state pays the trustee who represents the certificate purchasers. The certificates are \$5 thousand blocks, which encompass a municipal bond ranging in maturity from one, twenty, or thirty years. The yield, determined by the amount of time invested is paid semi-annually through the lease. The date that the certificate matures, the final interest payment and principal are received. The lease is subject to annual appropriation. In the event of failure to pay, the trustee is obligated to take control of the facility and attempt to make bond purchasers whole for the term of the lease. The certificates of participation are more limited than a GO commitment.

Co-Chair Stedman noticed that the table shaded in grey does not show interest rates. Mr. Mitchell responded that the interest rates vary.

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Co-Chair Stedman requested a report on the interest rates. Mr. Mitchell noted that the municipal market varied. Co-Chair Stedman asked if it was possible to call the bond in less than eight years. Mr. Mitchell answered that it would depend on the short term treasury market and the potential rebound.

Co-Chair Stedman asked for the Goose Creek Correctional Facility schedule. Outstanding obligations are continuously reviewed to determine whether opportunities exist to reduce cost. Senator Huggins requested the schedule for Goose Creek Correctional Facility.

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Mr. Mitchell discussed Slide 6 and the "Prudhoe Bay curve" that was expected in the early eighties.

JERRY BURNETT, DEPUTY COMMISSIONER, DIVISION OF TREASURY, DEPARTMENT OF REVENUE, stated that the GO bonds went to zero in 2001.

[9:44:06 AM](#)

Mr. Mitchell explained the various authorizations and projects. Co-Chair Stedman asked what categories encompass GO bonds. Mr. Mitchell answered capital projects and funds sold on tax exempt bases. He explained that GO bonds are

easier to administer and can be used for larger state projects.

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Co-Chair Stedman pointed out the outstanding GO bonds coinciding with high cash positions and savings. He believed that the policy discussion was whether or not the state must continue to engage in the administration of GO bonds versus paying cash. He requested a summary table of projects and their call date. He suggested a policy to liquidate or call all the GO bond debt. He wondered how soon the call could be implemented. Mr. Mitchell answered immediately, but the negative carry would be incurred in an escrow. All bonds in final maturity have a ten year call.

Mr. Mitchell explained that the calculus to determine the policy includes viewing the expectations for savings accounts on a comparable basis to these long term obligations. The state is a tax exempt borrower and investor. He explained that the state could purchase credits comparable to tax exempt credits at taxable rates. Bonds can that are issued by municipalities under the Build America Bond Program are taxable for purposes of the investor. Co-Chair Stedman stated that he understood arbitrage. The policy call includes GO bonds and debt outstanding. He expressed concern that the policy calls concerning debt are considered with heavier weight than some newspaper articles dealing with our budget.

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Mr. Mitchell addressed Slide 7: "Alaska Municipal Bond Bank" The handout provides an overview of outstanding loans to municipalities funded with bonds.

Co-Chair Stedman asked about communities whose financial condition is deteriorating. Mr. Mitchell replied that the bond bank has obligations to provide for certain community buildings. The purpose of the program is to help communities like Kaktovik, who receive the majority of their income from gaming, which carries a certain amount of risk. The city of Adak causes concern due to financial difficulties related to fish processors, remoteness, and size of community.

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Co-Chair Stedman spoke of the community known as Inter-island Ferry Authority that has undergone financial challenges with the shutdown of the northern route. He stated that the job of the committee is to help those committees facing difficulties. Mr. Mitchell explained that the Inter-island Ferry is another community that is in regular communication with the Alaska Municipal Bond Bank.

If the bond bank were not involved in the loan for Inter-island Ferry, the community would pay considerably higher interest rates for financing.

Co-Chair Stedman listed challenged communities as Kaktovik, Adak, and Inter-island Ferry. Mr. Mitchell clarified that Kaktovik has various challenges yet has never missed a payment.

Mr. Mitchell recalled that the community of Northwest Arctic Borough is thoroughly reliant on a mine and the mine is facing certain challenges.

Senator Thomas asked the definition of "community savings" as noted on Slide 7. Mr. Mitchell answered that the community savings represents the benefit to the community by having participated in the Alaska Municipal Bond Bank. The savings represent an estimate of the potential interest expense paid without participation in the bond bank. He provided examples.

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Senator Olson asked about the backup plan for the Northwest Arctic Borough. Mr. Mitchell responded that the borough has revenue reserves due to conservative investments made when the price of zinc was high. He explained that the mine will retain value taxable by the borough in the event that the mine cannot access a new ore body.

Mr. Mitchell addressed Slide 8: "Investment Grade Rating Categories" He explained the rating system.

- Bond ratings for the majority of municipal bonds are in the investment grade categories
- State of Alaska's General Obligation bonds are rated Aa2/AA/AA+
- Certificates of participation of subject to appropriation debt is rated Aa3/AA-/AA
- 13 states have at least one AAA credit rating
- 5 states have at least one A credit rating
- California lowest rated at A/Baa1/BBB

Co-Chair Stedman asked why Alaska did not receive a greater rating with the state's great cash resources. He thought Alaska was certainly more solvent than the Federal Government.

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Mr. Mitchell answered that the rating analysts have certain criteria including broad based taxes and diversity of economy. Since Alaska relies so heavily on oil, much

volatility exists. He opined that Alaska offsets the volatility with the reserve position.

Mr. Mitchell explained about expenditure trends and administrative factors on Slide 9: "Rating Factors for Alaska's General Obligation Bonds."

- Economic Base
 - Dependent on natural resource industries
 - non-renewable oil extraction industries
 - renewable resources fishing and timber
 - Tourism
 - Military bases
- Financial Analysis
 - Trend in expenditures
 - Oil generated revenue dependency and volatility
 - Projected decline in oil production and the Prudhoe Curve
 - Gas Line
 - Reserves (CBR, SBR, PF, etc.)
- Debt Analysis
 - Very low net debt after deductions for self-supporting and guaranteed debts
 - Debt conservatively managed
- Administrative Factors
 - Forecasting ability
 - Reserve policies
 - Investment strategies and performance
 - Services provided

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Senator Huggins requested information regarding the gas line's credit or debit. Mr. Mitchell responded that the state receives a credit in the gas line category.

Mr. Mitchell turned to Slide 10: "Alaska's State Supported Debt." He explained the impact education had which resulted in differing numbers.

Mr. Mitchell reviewed the "State Supported General Fund Debt Service" as depicted on Slide 11. The school debt reimbursement program is rebounding and will peak in FY11.

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Mr. Mitchell explained "Alaska's Debt Service to Unrestricted Revenue" (debt capacity) on Slide 12.

Historically, five to eight percent of unrestricted revenue constitutes the upper limit of capacity.

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Mr. Mitchell discussed "Recovery Act Opportunities" on Slide 13.

- Build America Bonds
- Recovery Zone Economic Development Bonds
- Recovery Zone Facility Bonds
- Qualified School Construction Bonds
- Other allocations smaller than statewide in nature

Mr. Mitchell explained "Advantages of Build America Bonds" as depicted on Slide 14.

- Alternative structure for financings that otherwise qualify as tax exempt.
- Sell taxable bonds and receive 35 percent subsidy from Federal Government on interest expense
- Beneficial on yields for maturities beyond 8-12 years depending upon market
- On 20 year loan has lowered interest rate by 50 to 100 basis points depending on market.

Mr. Mitchell elaborated upon "Recovery Zone Bonds" as depicted on Slide 15.

- Recovery Zone Economic Development Bonds
 - o Identical to BABs but a boosted 45 percent subsidy
 - o \$90 million allocation to Alaska
- Recovery Zone Facility Bonds
 - o Provide opportunity for municipalities to offer tax exemption to businesses investing in their communities
 - o \$135 million allocated to Alaska

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Mr. Mitchell listed the "Recovery Zone Allocations" as depicted on Slide 16. The allocations present a problem because they currently exist in census areas where a governmental body does not use them. These allocations require reallocation for use. He discussed the revenue bond for private businesses and the concern about allocations.

Co-Chair Stedman referred to Bethel's allocation. Mr. Burnett commented that the majority of the allocation in the Bethel census area cannot be used because it is allocated to an area without a local government possessing bonding

authority. He expected the introduction of methodology for reallocating the funds.

Co-Chair Stedman thought that the subject of reallocating these funds was important session work.

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Mr. Mitchell discussed Slide 17: "Qualified School Construction Bonds."

- Investor receives a tax credit as fixed percentage of the purchase
- Theoretically could have zero interest expense, but recent issues required supplemental coupon of 1.5 percent
- State's allocation is \$29,784,000 for both 2009 and 2010
- Must be a k-12 school capital project

Mr. Mitchell addressed Slide 18: "Municipal Market Update."

- Total issuance for 2009 was \$407 billion, with fixed rate bonds accounting for \$360.7 billion (89%)
- Taxable issuance was \$84.1 billion in 2009; Build America Bonds (BAB) account for \$64.2 billion of taxable issuance
- Insurance penetration fell to 8.7% in 2009
- Credit spreads have been shrinking since credit crisis, but have widened slightly recently
- Yield curve historically steep and fixed rates remain near historic lows
- Retail showing less appetite with such low rates

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Mr. Mitchell addressed Slide 19: and the "Market Update Fixed Rate Bonds." He stated that the current "AAA" Municipal Market Data (MMD) has been lower than today only 1.73 percent of the time since January 1 1990. Interest rates have never been lower.

[10:26:07 AM](#)

Mr. Mitchell detailed Slide 20 and the "Alaska Municipal Bond Bank". He described the analysis.

Co-Chair Stedman addressed the upcoming bond related legislation. He assumed that the committee would spend time addressing the issue.

[10:28:44 AM](#)

Mr. Mitchell Slide 21: "Current Cost of Capital" He explained that the table provides a simple interest rate and amortization comparisons.

Mr. Mitchell explained the summary on Slide 22.

- Conservative use of State Debt
- Capacity to consider Additional Borrowing
- Estimate \$1 to \$2 billion in Capacity at Current Credit Rating
- Current structuring opportunities in the American Recovery and Reinvestment Act (ARRA)
- Lower absolute interest rates than at any point in the last 20 years.

Mr. Burnett commented on congressional legislation to extend the BAB concept. The cost to the treasury is tax exempt.

Senator Thomas asked about funding for the Life Sciences Building and the Crime Lab using certificates of participation under ARRA. He asked if the certificates of participation were the best scenario offered for the lowest possible interest rate. Mr. Mitchell replied that efficiency is achieved through combination of certificates of participation. He stated that the combination would provide a transaction with low interest rates.

Senator Thomas asked if the state was taking full advantage the current low interest rates. Mr. Mitchell answered yes. Senator Thomas asked whose responsibility it was to redirect funding for the Life Sciences Building. Mr. Mitchell answered that the Fairbanks North Star Borough can take advantage of the economic development bonds or other GO bond issues within the borough. The borough can allocate to the city of Fairbanks which can sell revenue bonds without a vote, but they cannot allocate outside the area.

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Mr. Burnett clarified that legislation would allow another entity to reallocate funds between projects.

Senator Huggins commented that the recovery act makes him nervous. He observed an excess of \$1 trillion deficit on the federal level and Alaska contributing to the deficit.

Mr. Mitchell explained that the ability to sell tax exempt debt is a structuring alternative available to municipalities. The recovery act includes a standing appropriation for reimbursements to the issuers. He believed that enough acceptance is present, making it unlikely that a congressional act would change the standing appropriation.

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Senator Huggins stated that he is still nervous.

Co-Chair Stedman introduced the "FY11 Governor Debt Obligations and Revenue Sources" (Copy on File) from the Office of Management and Budget (OMB). He pointed out the obligations listed including the Crime Lab, the Virology Lab, and the University of Fairbanks Life Sciences Building. He noted that the discussion regarding these debt obligations would be addressed during the upcoming capital budget process.

[10:40:11 AM](#)

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ADJOURNMENT

The meeting was adjourned at 10:40 AM.