

SENATE FINANCE COMMITTEE
February 24, 2011
2:33 p.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 2:33 p.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Lesil McGuire, Vice-Chair
Senator Johnny Ellis
Senator Dennis Egan
Senator Donny Olson
Senator Joe Thomas

MEMBERS ABSENT

None.

ALSO PRESENT

Joseph Schmidt, Commissioner, Department of Corrections; Jeff Stark, Attorney, Department of Law; Kevin Worley, Internal Auditor, Department of Corrections; Leslie Houston, Director of Division of Administrative Services, Department of Corrections; Deven Mitchell, Debt Manager, State Investment Officer, Department of Revenue.

PRESENT VIA TELECONFERENCE

Ted Leonard, Executive Director, Alaska Industrial Development and Export Authority; Brian Bjorkquist, Senior Attorney General, Department of Law.

SUMMARY

^Presentation on the Goose Creek Correction Center by the Department of Corrections

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Co-Chair Stedman informed the committee that the department had been requested to relay the history of the project, discuss the original Senate bill that created the endeavor, and lay out the objectives of the facility. He hoped to examine the process of the project in order to identify which objectives had, or had not, been met. He expected the department to present the anticipated impact of the prison on the operating budget. He remarked that the Goose Creek facility was a large capital budget project with many economic factors. He felt that background information concerning the project would be necessary for a full understanding of the endeavor.

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JOSEPH SCHMIDT, COMMISSIONER, DEPARTMENT OF CORRECTIONS, presented a PowerPoint presentation: "Department of Corrections Presentation on Goose Creek Correctional Center" (copy on file). He stated that the Goose Creek Correctional Center (GCCC) project began in 2003. He displayed Slide 2 (an aerial view of the prison, from August, 2010), and stated that the perimeter of the facility was to be much like the maximum-security prison in Seward. He shared that the prison was expected to function like a "city within a city," and that the facility was designed under the expectation that the prisoners would be responsible for the various aspects of daily life. He offered that allowing the prisoner to function as a normalized member of the prison community would help to lower prisoner recidivism rates.

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Commissioner Schmidt discussed Slide 3, "Goose Creek at a Glance":

- Consist of five buildings with 435,000 square feet on 150 acres.
- Maximumimum security-like perimeter.
- Provide 1,536 beds for medium security sentenced inmates.
- 1,280 General Housing
- 128 Special Management Unit
- 56 Administrative Segregation
- 56 Punitive Segregation
- 16 Medical Segregation

- Employ a staff up to 345.
- Inmates participate in the everyday responsibilities and operations of the facility (mail, kitchen, laundry, etc.).
- On site medical clinic.

He stated that the higher-cost 56 Punitive Segregation beds had been positioned in the center of the compound in order to aid in the event of an overflow on pre-trial housing needs. He explained that prisoners navigating the pre-trial process tended to be more hostile and would benefit from the isolated housing environment. An on-site medical clinic would be present on the grounds, as well a hospital unit. The intent was to handle as much medical business as possible in-house.

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Commissioner Schmidt displayed Slide 4, "Opening of Goose Creek Correctional Center.":

- Ready for occupancy March, 2012...the last four months of FY 2012.
- Open with approximately 30 selected prisoners, small staff contingent.
- Prisoners will move from mod-to-mod testing electronic systems, intercoms, doors, run kitchen, laundry.
- Full ramp-up will begin July 1, 2012 - September 30, 2013 (FY13 - FY14). Transfer of prisoners and staff recruitment and training paced over 15 months.
- Experienced department staff will have an opportunity to transfer to Goose Creek Correctional Center (GCCC) when it opens.
- Staff will be recruited and hired to backfill vacancies. Hiring will occur at institutions throughout the state.

He stated that the average growth of the prison population would fluctuate, and that the opening plan would need to be modified accordingly. He noted that hiring the 345 employees would be a challenge, but that the recruitment and training programs were strong and would be a sufficient resource to draw from for hiring purposes.

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Senator Ellis probed the deeper impact of the GCCC on the staff of already existing facilities. He expressed concern for the safety and security of the already thinly-staffed facilities. Commissioner Schmidt replied that in a 2010 survey, 67 corrections officers (or one-third of the correctional workforce) in the state had expressed interest in transferring to GCCC. He relayed that the backfill consisted of people from primarily Anchorage and Seward. He said that the staffing issue was one of the reasons for the slow ramp-up to the opening of the facility. He admitted that the issue was a substantial challenge.

Senator Ellis wondered whether a delay in opening GCCC would require revisiting the backfill procedure. Commissioner Schmidt replied "absolutely." He stated that staff would not be hired until the facility was officially open.

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Commissioner Schmidt said that the department had held in-depth discussions concerning staffing costs. During the development of the staffing model, prisoner classifications had been examined. In the state, prisoners are classified as minimum/medium and closed/maximum. The department studied the per day costs of the minimum/medium facility in Palmer, and then a closed/maximum facility in Seward, to determine the per day operating cost for GCCC. He felt that the cost would fall between the Palmer and Seward facilities, recognizing a slight increase for the on-site medical offerings. Palmer Correctional Center costs \$68.52 cents per day to operate; Spring Creek in Seward runs \$104.00. Goose Creek was expected to cost \$86.72 to run per day.

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Commissioner Schmidt discussed Slide 6, "Annual Average Daily Inmate Population." The graph reflected the projected daily inmate population for 2012 consisting of 1,050 inmates out-of-state, and 3,895 in-state. The increased in-state number reflected the additional 64 beds being built in Kenai. He pointed out that the population dipped in 2008 to 2009, but that the increased projection for 2012 seemed realistic.

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Commissioner Schmidt displayed Slide 7, "Projected Inmate Populations for 2013-2014." The slide presented a quarter-by-quarter breakdown of FY 13 and FY 14. On July 1, 2013, the first staff members would be moved to the facility, hiring processes would be in action, and training academies would be running. Presented was a difference of 220 out-of-state inmates between the first and second quarters, which reflected the amount of inmates that could be flown out-of-state in two airplane loads. Ideally by the first quarter of FY 14, the facility should be at full capacity and fully operational. The first budget request encompassing an entire year would be made for FY 14.

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Co-Chair Hoffman pointed out to the committee that of the 1,536 beds, 1,050 were expected to be filled by out-of-state inmates. He wondered where the other nearly 500 inmates would be pulled from. He queried the plans for improvements to the other facilities named in the original SB 65, specifically in Kodiak, Dillingham, Yukon/Kuskoquim, and Spring Creek in Seward. Commissioner Schmidt replied that prisoners would be drawn from facilities that were currently over-capacity. He admitted that the facility in Bethel presented challenges due to accessibility and transportation issues.

Commissioner Schmidt stated that when SB 65 was passed, the site at Goose Creek had already been chosen and that the City of Bethel had been supportive of the project. At that time the department examined the size and cost of the project and made comparison with the needs of the prison population throughout the state. After examination the project was downsized from 2,250 to 1,536 beds. It was determined that the facility in Seward would have adequate space for the closed/maximum prisoners if the minimum/medium population was moved to a different or new facility.

Commissioner Schmidt stated that another reason for downsizing the project was to broaden the reach of the resources. He said Bethel had been considered for a 120 bed expansion, but that a change in city council had led to termination of the plan. He stated that the city council

had alternated its stance on support of the resolution right up to the July 1, 2009 deadline that had been written into Section 5 of SB 65. He offered that the department had been interested from the beginning in the Bethel expansion, knowing the overcrowding issues faced by the facility there. The department was currently focused on GCCC, but was anticipating the future needs of facilities in both Fairbanks and Bethel.

Co-Chair Hoffman queried the timeframe for improvements to the Bethel facility. He revealed that he had met with department staff and had acquired documents that reflected that the expected completion date of a Bethel facility was 2015, with the first requests for funding in 2012 for \$16,681,000.

Co-Chair Stedman pointed out to the committee that the \$16,681,000 for the Bethel project was not listed in the budget.

Senator Hoffman agreed that the funding was not listed in the budget, but had been listed on the Capital Project Submission and Information System (CAPSIS).

Commissioner Schmidt replied that he understood that there was great need for expansion in Bethel and that the community had been close to supporting further expansion. He said that the department had not been able to reconcile all of the issues raised by the community in Bethel. He reiterated that the facility was overbooked and in need of expansion.

Co-Chair Hoffman reminded the committee that there was documentation from the department that illustrated the preliminary plan; the cost would be \$143 million for a completed 80-bed facility in Bethel. Also documented was the need in Fairbanks to establish a 152-bed facility by 2016, and another 200 beds by 2020. He queried the current plans for the two facilities. Commissioner Schmidt replied that the department would need to revisit those projects during the interim. Presently, the main focus for the department was the opening of the facility at Goose Creek.

Co-Chair Hoffman reasoned that the projects should be underway if the plans had been developed to meet the needs in the two facilities. He noted that often many schools were built simultaneously in the state and hoped that the

department was capable of building more than one prison at a time. Commissioner Schmidt responded that the department was capable of building two prisons at a time, but that GCCC was the focus at present.

Co-Chair Hoffman asserted that in discussions over the last three years, DOC had given assurances that the needs in Fairbanks and Bethel would be met. He pressed for a timeline for the projects to be completed. Commissioner Schmidt restated that the project lost inertia when the community of Bethel voted not to support it.

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Co-Chair Hoffman stated that SB 65 had expired, but the needs highlighted in the legislation had not. He opined that the interest of the department, not the needs at the Bethel facility, had expired. Commissioner Schmidt replied that the department was still aware of the needs at the facility in Bethel.

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Senator Olson wondered how the issue of overcrowding might be remedied. He felt that the department was taking a narrow view of the future by concentrating all of its time and resources on one prison. Commissioner Schmidt replied that the department recognized that the prison population in Bethel was growing, but that there was only so much money that the DOC could request. He said that bringing prisoners home was the priority. He relayed that \$22 million was being spent on out-of-state prisoners each year. He asserted that the department's main focus had been on better reintegration of prisoners after release, in order to lower recidivism rates.

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Co-Chair Stedman requested that the department lead a broader discussion of SB 65.

LESLIE HOUSTON, DIRECTOR OF DIVISION OF ADMINISTRATIVE SERVICES, DEPARTMENT OF CORRECTIONS, discussed Slides 8 through 10: "History of Goose Creek Correctional Center":

February 2003 - SB 65 was introduced.

- This bill was introduced as a financing mechanism to expand correctional facilities within the state.
 - Mandated local governments to bond for construction of a prison.
 - Fairbanks 80 bed expansion
 - Bethel 120 bed expansion
 - Seward 144 bed expansion
 - Unidentified Region, 1200-2251 bed facility (Mat-Su selected, Goose Creek site selected)
 - Kodiak Community Jail, 6 bed expansion
 - Dillingham Community Jail, 17 bed expansion
- May 2004 - SB 65 passed unanimously.

•July 2004 - Memorandum of Understanding between Mat-Su Borough, Alaska Housing Finance Corp. (AHFC), and Department of Corrections (DOC) with the agreement to develop the prison in the Mat-Su Borough.

Ms. Houston stated that a recent engineering study had shown that the facility at Fairbanks should be completely replaced rather than expanded. She admitted that the department was behind on the expansion of the Bethel facility, but that it was "on the radar." The Seward expansion had been determined to be unnecessary. It was found that more minimum-security beds were needed and not maximum-security. She shared that there had been land transfer issues regarding the Seward expansion. The 6-bed expansion in Kodiak had been completed on February 4, 2011. The community of Kodiak had supplied a \$2 million match to see the project to completion. The state appropriated \$2.1 million through the Department of Commerce, Community and Economic Development (DCCED). The Department of Corrections (DOR) was able to provide a \$300,000 one-time item to the community to keep the old facility running while the new one was being built, this would be an \$188,000 increment to the base contract in FY 12. The expansion in Dillingham had not been realized, but the department hoped to reestablish a relationship with the community.

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Co-Chair Hoffman contended that SB 65 had not been a proposal, but a piece of legislation that had been passed. He argued that since the passage of the legislation, no progress had been made, and that the facilities listed were

in the same condition in 2011 as they were in 2003. He suggested a lack of leadership from the administration in addressing the problem.

Co-Chair Stedman highlighted the fact that there were locations written into the legislation that had yet to be addressed. He pointed out to the committee that the original bill had set the inflation adjusted total bed cost limit at \$135,000 for Mat-Su, Fairbanks, Anchorage, and Seward. He wondered where the department was to-date, concerning the intent of the original legislation. Commissioner Schmidt replied that the figure had been \$135,000, plus inflation. He said that the Department of Law had given DOC permission to use construction inflation, as at the time construction inflation was outpacing the Consumer Price Index (CPI).

Co-Chair Stedman requested that documentation of the use of construction inflation be submitted to the committee. He cited Page 3, Line 14 of SB 65:

(1) the average capital cost for all beds may not exceed \$135,000 a bed for (a)(1), (2), (4), and (5) of this section and \$155,000 a bed for (a)(3) of this section, adjusted for inflation each year at a rate equal to the percentage increase in the Consumer Price Index for urban wage earners and clerical workers for Anchorage, Alaska, during the previous calendar year as determined by the Bureau of Labor Statistics, United States Department of Labor;

Co-Chair Stedman felt that the language was quite specific in its intent. Commissioner Schmidt assured the committee that the documentation of the numbers would be provided at a later date.

Co-Chair Stedman wondered how the committee should reconcile the capital construction limits of the original bill as being met, when only one of the listed projects had been completed. Ms. Houston stated that the cost per bed outlined in the bill had been exceeded.

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Co-Chair Hoffman stated that he believed that DOC broke the law. Ms. Houston stated that the economy changed from the

time that the bill was passed to the time that ground had been broken at Goose Creek.

Co-Chair Hoffman offered that perhaps the department had followed a subsequent law that had changed the per bed figure. Ms. Houston rebutted that the department had done everything possible to scale back the project. She added that when the bonds for the project were issued in 2008 the economy was severely struggling.

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Co-Chair Hoffman revealed that he was still waiting to hear about the utility costs as laid out in SB 65.

Co-Chair Stedman said the annual lease payment set out in SB 65 was 11,600 per bed. The original Goose Creek plan was for 2,250 beds, with a lease cost of \$15.3 million. He questioned why the project now was at 1,536 beds, and the lease cost had increased to \$17.8 million. Ms. Houston could not speak to the lease payments. She deferred the question to the Department of Revenue (DOR) and the Department of Law (DOL).

Co-Chair Stedman wondered if the downsizing of the project was a result of the lease payment structure. Ms. Houston replied that she did not know.

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Co-Chair Stedman asked if the department was comfortable with the size of the Goose Creek facility. Commissioner Schmidt felt the facility was the correct size.

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JEFF STARK, ATTORNEY, DEPARTMENT OF LAW, referred to the issue of CPI versus construction inflation. He stated:

"I think there is a little bit of confusion in terms of what we did and how we got to the number. I don't believe it was actually construction CPI that we used because I don't think there is any such number that's generated. What we did look at, and what LAW did approve, was the issue of whether that adjustment went through the date of essentially signing the contract, or whether the adjustment

should continue throughout the entire construction process."

Mr. Stark shared that he had carefully analyzed the language of SB 65. He said that the construction CPI did not use a different index and that it was a question of what period of time was being used to measure it. The department had used the period of time up through and including construction. Estimates had been provided in terms of how much of the construction would be completed in each year and no adjustment had been made for work that had already been completed.

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Co-Chair Stedman queried the Alaska Industrial Development and Export Authority (AIDEA) financing vehicle for the utilities. He wondered how the financing matched up with keeping within the \$11,600 per bed constraint. Mr. Stark responded that the AIDEA financing was a complex transaction. The loan was not being made to the state or to DOC but to a private developer. He reminded the committee that the facility at Goose Creek was being built by and was owned by the Mat-Su Borough. The borough put out a request for private developers to design, build, finance, and operate the water and wastewater facility. The idea was that the services provided to the facility could expand into the broader community as the area developed, which would spread the cost of development to all users in the area. Valley Utilities LLC., the current developer, retained the AIDEA loan and will repay the AIDEA loan in its entirety. The DOC was expected to pay an operating fee to Valley Utilities. The operating expense would incorporate the debt service that Valley Utilities will have to pay. He noted that this would be a one-user utility and DOC would pay for the service until the area saw more development.

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Co-Chair Stedman wondered if all the elements of SB 65 had been implemented as originally intended. Mr. Stark believed so. There were no lease payments or capital expenses that were being made in excess due the water and wastewater facilities. The expenses were operating expenses and would not be considered a construction expense. Although the

operating expenses would be high for the first few years the expense fit within the framework of the original bill.

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Co-Chair Stedman expressed discomfort that all the elements of the original bill had been implemented. He hoped for further review. Mr. Stark offered to explain how the relationship between the water and wastewater utility and the lease facility worked.

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Co-Chair Hoffman reiterated that he was a sponsor of SB 65, and the original intent was that all the costs be calculated under the per bed cost, and not to subsidize additional sub-division costs. He asserted that if the prison had not been built in the area, the utility would have never existed. Mr. Stark agreed. He said that the purpose for building the prison had not been to subsidize other development in the area.

Co-Chair Hoffman understood that the intent had not been to subsidize other development, but that that seemed to be the current situation. He felt that there were nefarious actions being taken to justify the financing of the project. He stressed that the intent of SB 65 was that all costs were to be related in order to justify the per bed cost. Mr. Stark replied that in late 2008, DOC was finalizing contracts with the state and the utilities had been excluded from discussion at that time. He added that construction of utilities was not normally part of the construction cost for a prison facility. The facility would usually hook up to whatever facilities were already established. Had the prison been built in a more populated area, the utility expense would have been alleviated.

Co-Chair Hoffman highlighted that the site for the project was selected in an area where utilities were not available. He argued that the facility should have been built closer to available utilities. He voiced distain for the "complicated financing mechanism" used to bring utilities to the site.

Co-Chair Hoffman asked what portion of the utility costs at Goose Creek could be directly attributed to the construction of the facility. Mr. Stark replied that

replied that only DOC would presently be using the utilities in the area. He furthered that it was expected that within the next decade there would be more development near the facility, which would result in more facilities hooking up to the utilities. He did not offer full confidence concerning the expectation of development in the area.

Co-Chair Hoffman felt that the department had disregarded the intent of the law; the building of the utilities should have been part of the construction costs, or the facility should have been built near existing utilities. Mr. Stark reminded the committee that DOC was not building the facility. The MatSu borough was building the facility. Because of the way SB 65 was structured, it was not simply a matter of DOC deciding where the prison should be built. The decision of where to build had been largely driven by the borough.

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Co-Chair Hoffman pointed out that DOC would have needed to see the initial numbers and justify the cost under the intent of the law. He asserted that it was not the Mat-Su that was in charge of making that decision. Mr. Stark replied that it was the responsibility of the Mat-Su Borough to solve the utilities problem.

Co-Chair Hoffman contended that it was the responsibility of the department to examine the financing mechanism in order to ensure that the intent of the law was being followed. Mr. Stark said that was correct. He recalled the 2008 decision to move forward with construction of the prison, at that time DOC and the borough had been in discussions about how to solve the utility problem. Because they were a separate facility from the prison, it was decided that the utilities should be excluded from the discussion. The hope was that discussions would continue as the project progressed.

Co-Chair Hoffman wondered what decision was made first:

- Build the facility and worry about the water and sewer financing later.

- Work on the financing of the water and sewer and then build the facility.

Mr. Stark replied that the decision to build the facility had been made long before the water and sewer had been considered.

Co-Chair Hoffman understood that lack of consideration for water and sewer must have presented a problem once the facility was built. Mr. Stark said yes. He maintained that the department's actions had complied with the original intent of SB 65.

Co-Chair Hoffman testified that as a co-sponsor of the original bill the department had not honored the intent of the legislation.

Mr. Stark stated that DOL had examined SB 65, and concluded that the way that the deal was structured fit within the language of the bill.

Co-Chair Stedman expressed concern that the financial arrangement was questionable. He felt that it should have been brought before the committee for consideration. He believed that the utilities discussion should have been brought before both finance committees, as those bodies hold the appropriating power of the legislature, and lamented having read about the "complicated financial arrangement" in the newspaper. He agreed that some creative financing may be legal, but that it was not good public process when dealing with the treasury of the state.

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Senator McGuire echoed the comments of Co-Chair Hoffman. She felt that the problem of regional balance should be recognized. She shared that one of the goals of the legislation had been to recognize that the prisoner population in the state was growing, which forced the state to send inmates out-of-state at an unsustainable cost. She explained that the original SB 65 discussion had involved where inmates were being transferred to and how facility expansion and upgrades across the state should be addressed. She expressed concern that the department had not returned to the finance committee for approval of the inflated cost of the project and that this had led to the neglect of other regions of the state. She noted that Bethel had been targeted for lowering domestic violence and crimes against children, but that the prison there had been

operating over capacity since 2003. She concluded that the intent of the legislature was not being carried out.

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Ms. Houston continued with Slide 8: "History of Goose Creek Correctional Center."

- June 2006 - Site selection process began.
 - With a plan to construct a 2,250 bed facility.
 - 800,000 square feet all under one roof.
 - Capable of housing close/maximum prisoners.
 - Public hearing and open houses were held.
- June 2007 - MOA with AHFC expires, effectively removing AHFC from project involvement.

- June 2007 - The decision was made by DOC to downsize GCCC to 1,536 beds and change the classification level to medium security.
 - To build a 2,250 bed facility was projected to cost \$490M.
 - It would mitigate DOC's ability to spread resources across the state.
 - The largest prisoner population is medium security.

Co-Chair Stedman asked why the decision had been made to downsize the facility. Commissioner Schmidt replied that the greatest need was among the medium-security prisoners, and that building maximum-security prisons was more expensive.

Co-Chair Hoffman requested a white page detailing the sources of inflation factors for the \$11,600 per bed calculation which led debt services to raise the limit to \$17.8 million. Ms. Houston agreed to prepare a report.

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Ms. Houston detailed Slide 9: "History of Goose Creek Correctional Center Continued..."

- February 2008 - Mat-Su Borough and DOC execute an MOU to plan and finance a prison.

- June 2008 - Mat-Su Borough issues design/build request for proposal (RFP) for the prison.

- August 2008 - Mat-Su Borough published request for qualification (RFQ) to design, build, operate & finance a water/waste water facility for GCCC.

- October 2008 - Deputy AG Tillery issues a legal opinion that CPI for Construction Inflation can be applied for services received during subsequent time period; this does not violate SB65 per bed formula.

- December 2008 - DOC requests \$20 Million for FY10 Capital Budget.

Co-Chair Stedman requested a copy of the October 2008 letter from Deputy Attorney General Craig Tillery. Ms. Houston said a copy of the letter would be provided.

Co-Chair Hoffman thought a second opinion would be necessary.

Co-Chair Stedman wondered what happened to the \$20 million the department had requested in the FY2010 Capital Budget.

Ms. Houston continued with Slide 10, "History of Goose Creek Correctional Center Continued...":

- December 2008 - State of Alaska Lease Revenue Bonds sold by Mat-Su Borough provided \$240,073.2 to fund GCCC.

- May 2009 - Mat-Su Borough publishes a RFP for a contract to design, build, operate and finance the water/waste water facility to support GCCC.

- July 2009 - DOC secures \$6M appropriation in FY10 Capital Budget for utilities and infrastructure.

Ms. Houston replied that in July of 2009, \$6 million of the \$20 million request was secured. The funding was for utilities and infrastructure.

Co-Chair Stedman asked if the request had been reduced by the administration before submission to the Capital Budget on December 15. Ms. Houston replied in the affirmative.

Co-Chair Stedman understood that the request had been submitted to the governor for consideration to be included in the FY2008 budget, and \$6 million was put forward in the Capital Budget. Ms. Houston replied that a multi-year appropriation had been submitted showing \$6 million in FY2010, \$9.5 million in FY2011, and \$4.5 million in FY2012. The department received the \$6 million and did not come back to the legislature the subsequent fiscal years.

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Co-Chair Hoffman wondered why the additional \$13 million had not been requested. Ms. Houston believed that the project had been at a point where the \$6 million had not been entirely allocated. The department examined the various utility infrastructure and road improvements that needed to be made and chose not to return to the legislature at that point in time.

Co-Chair Hoffman asked it was at that point when "creative financing" took over. Ms. Houston replied that the department had simply made an effort to expend the \$6 million that had been appropriated for the fiscal year.

Senator McGuire asked if Valley Utilities was regulated by the Regulatory Commission of Alaska (RCA).

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Mr. Stark responded that the RCA would gain jurisdiction over the utilities once 10 customers were online.

Co-Chair Stedman understood that RCA jurisdiction would be automatic once the 10 customers were online. Mr. Stark responded yes. He corrected that it could be 5 customers and not 10. He said he would check the number. At the point that the determined amount of customers were on line, Valley Utilities would be required to obtain a certificate from the RCA, who would ultimately govern the utility rates.

Co-Chair Stedman asked if the utility line had been constructed in a manner for easy connection. Mr. Stark replied in the affirmative.

Co-Chair Stedman requested data regarding how the utility line was engineered for expansion. Mr. Stark reiterated that the situation was complex.

Co-Chair Stedman countered that the committee could handle the complexity. Mr. Stark stated that the water treatment system had been incorporated as part of the actual prison. The boundary lines for the prison under the lease purchase agreement were altered for the incorporation, and funds from the \$240 million bond issue were being used. The wastewater facility could someday become a public utility.

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Co-Chair Stedman requested the sizing of the water and wastewater treatment facilities, relative to the size of the GCCC. Mr. Stark agreed to provide that information.

Co-Chair Stedman requested information concerning the size of the lines that were being put in the ground for the water and sewer.

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Co-Chair Hoffman asked if the department had approached RCA concerning the one customer use of the utility, and if the commission had agreed that approval did not have to go before them. He also asked if the department had informed the commission that the utility would eventually be servicing additional customers. Mr. Stark replied no. He offered that the requirements could be found in statute.

Co-Chair Hoffman wondered why no one had been in talks with the RCA. Mr. Stark reiterated that the statute was clear in terms of when the RCAs jurisdiction was invoked.

Co-Chair Hoffman queried if the RCA would agree with Mr. Starks opinion. Mr. Stark countered that he had assurances from RCA attorneys.

Co-Chair Hoffman asked if the agreement had been documented in writing. Mr. Stark replied no.

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Ms. Houston continued with slide 10: "History of Goose Creek Correctional Center Continued.":

- March 2010 - Valley Utility proposes to finance the water/waste water facility using tax exempt private activity bonds issued by the Mat-Su Borough.

- April 2010 - The State of Alaska Department of Revenue expresses concern about issuing state supported debt that exceeds the authority of SB65.

Co-Chair Hoffman asked if the concern by DOR had been issued in writing. Ms. Houston replied yes.

Co-Chair Hoffman requested copies of the document.

Co-Chair Stedman requested further explanation of the lease revenue bonds, particularly, the yield on the bonds and the potential cost fallback against the state. He asked that any action taken to lower the cost to the state be further explained to the committee.

DEVEN MITCHELL, DEBT MANAGER, STATE INVESTMENT OFFICER, DEPARTMENT OF REVENUE, thought that SB 65 had been the result of the state being in a weak financial position and the desire to provide for infrastructure. The Department of Revenue had been reluctant at the time to support credit being used as a means of providing for funding for correctional facilities. The alternative means of funding in SB 65, community bonding, was viewed by DOR as a way to reach the goal of building new correctional facilities. He stated that in the end, the Mat-Su project provided the most workable plan. Fairbanks could not issue revenue bonds without a vote. Also, the prison was in the city and the borough was given the authority to issue the debt. He stated that he travelled to Bethel and explained to the community that the state would be paying the debt service and would be liable concerning obligation issues. He said that the Bethel City Council had been uncomfortable with the explanation and had been unwilling to move forward with

the financing. He relayed that legal issues relating to the original financing, land control, and a collocated wastewater facility at Spring Creek had proved immovable hurdles in Seward. Location issues arose in Mat-Su due to Mat-Su borough assembly requirements. The bonds for the Mat-Su project were sold in late 2008.

Mr. Mitchell believed that the delay from 2004 to 2008 had been related to DOR's reluctance to participate in the transaction during the Murkowski Administration. He added that the department had initially issued a veto recommendation for SB 65. The department changed position with shift from the Murkowski to the Palin Administration. In late 2007 a design project was developed but the department was not in a position to sell the debt until late 2008. He remarked that interest rates were very high when the transaction occurred, and rates were met to pay the lease. The department was unable to sell the bonds in December 2008 and failed to meet the target of 17.8 million identified in the bill. At that time, the \$135,000 per bed cap was not adjusted for inflation and the allowed cost was approaching \$280 million. The \$240 million deposit to the construction fund was smaller than what would have been permitted had the department been allowed a larger annual lease payment.

Mr. Mitchell furthered that on December 21, 2008, the underwriter contacted Franklin Funds, who was willing to offer \$60 million on the bonds as an anchor tenant. Subsequently, the department was able to fill out an order book and successfully place the bonds. The bonds have a true interest cost approaching 6 percent. He admitted the percentage was high, and was more than would be expected to be paid if it was a state general obligation bond, but that it was relative to the AAA scales of 2008. He explained that 2008 was a troubling time and that the investor had to look at the Mat-Su lease revenue bond page-by-page to understand that the state was ultimately responsible.

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Mr. Mitchell relayed that the bonds were refinanceable, but had a 10 year call provision, which meant refinancing could not occur within the first 10 years of the loan. After the 10th year of issuance, the last 15 years of the loan could be refinanced. Currently, there was no ability to refinance

because of the negative carry-on the escrow to the call-date on an advance refunding basis.

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Co-Chair Hoffman wondered how much would be paid on the bonds in the end. Mr. Mitchell replied \$442,172,506.88. He added that the bonds were sold for a slight discount, so less than the par amount was received.

Ms. Houston continued with Slide 10.

- April 2010 - DOC formulates a three pronged strategy to reduce the annual fees for the water/waste water facility. (detail of strategy on next slide)

Ms. Houston discussed slide 11: "Three-Pronged Strategy.":

- 1.) Value Engineering of the water and waste water facility. These efforts have resulted in cost reductions of approximately \$2,000,000.

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Co-Chair Stedman asked how value engineering was defined. Mr. Stark replied that value engineering meant the cost savings through the construction process. Under the original request for proposal, Valley Utilities had proposed to construct the entire water/wastewater facility for \$27 million. He added the project was a "design build", which was a method to deliver a project in which the design and construction services are contracted by a single entity.

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Ms. Houston continued to discuss slide 11:

- 2.) Use of alternative funding sources. The DOC and Valley Utilities agreed to break the project into four segments. One of the segments was funded by DOC from existing appropriations; one segment was incorporated into the prison itself and funded from surplus proceeds from Mat-Su Borough's prison bonds; a third segment from Valley Utilities equity contributions; leaving only the wastewater treatment plant to be

financed. The amount financed will be about ½ of the original estimate.

<u>Segment</u>	<u>Pay Estimate Schedule Costs</u>	<u>Funding Source</u>
Pipeline	\$1,693,477.00	DOC Existing Approp. FY10 GF
Water	\$5,109,130.28	GCCC Bonds
Well Field	\$1,447,842.04	Valley Utilities Equity Contributions
Waste Water	\$14,264,367.5	AIDEA

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3.) Seek alternative funding sources to reduce cost of debt service. In addition to the private placement of the sale, several alternatives were evaluated including direct appropriation.

Co-Chair Stedman wondered if the equity contribution had been cash. Ms. Houston believed that it was a loan from Wells Fargo that Valley Utilities made directly. Mr. Stark furthered that Valley Utilities contributed \$2 million into the project. The remaining construction financing was coming from Wells Fargo. Essentially, AIDEA was providing "take-out" financing from Wells Fargo. The AIDEA interest rate was at a lower rate than the Wells Fargo financing, and AIDEA was borrowing from Wells Fargo on a quarterly basis as construction proceeded. Wells Fargo was providing the expertise on evaluating the percent completion of construction and determining the proper amount of the draws.

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Ms. Houston displayed slide 12: "History of Goose Creek Correctional Center Continued.":

- April 2010 - GCCC Project Committee authorized the use of up to \$5,400,000 in GCCC contingency fund for construction of the water/waste water treatment plant.

- October 2010 - Valley Utilities requested permission to proceed with the private placement bond sale at a total interest cost between 8-9%. DOC rejected this proposal and began exploring financing alternatives through Department of Environmental Conservation and ultimately AIDEA in an effort to reduce the State's future debt services component of operating costs.

- December 2010 - AIDEA Board approved financing.

- December 2010 - AIDEA sold AA-rated bonds publically that achieved a total interest rate of 5.13%. The bonds are supported by a general obligation pledge of AIDEA rather than the State's credit. By acting expeditiously, AIDEA achieved an interest rate that is approximately 1 to 1.5% lower than it would be in the market of late-January 2011.

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Co-Chair Hoffman referred to Slide 12, and asked what the justification was for the tax-exempt bonds. Ms. Houston believed that the tax-exempt bonds were a result of the American Recovery and Re-investment Act (ARRA).

Co-Chair Hoffman asked if the tax-exempt status was the result of Valley Utilities providing service to a state agency.

TED LEONARD, EXECUTIVE DIRECTOR, ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY (via teleconference), replied that the bond would have been tax-exempt if the Internal Revenue Service code requirements were met for a "project of this type".

Co-Chair Hoffman asked if a "project of this type" meant building a line to a state correctional facility. Mr. Leonard clarified that it meant that the money was funding a utility that was providing services to a state operation.

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BRIAN BJORKQUIST, SENIOR ATTORNEY GENERAL, DEPARTMENT OF LAW (via teleconference), added that the bonds were issued as tax-exempt/private activity bonds. Under the federal tax code, the ability to issue bonds on that basis ended at the

end of 2010. He did not know if the tax-exempt status had been based on the utility providing to a state agency. He said he would consult bond council and provide an answer to the committee.

Co-Chair Hoffman requested that the attorney general and the bond council clarify whether the bonds would retain tax-exempt status if the utility were to be used for residential purposes.

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Mr. Bjorkquist concluded that as "exempt facility bonds", the bonds would be tax-exempt whether they were issued in 2010 or 2011. He clarified that the advantage of issuing before the end of 2010 was based on the alternative minimum tax code (AMT). Under ARRA, there were exemptions from AMT which lowered the cost of funding by 150 basis points. The state saved approximately \$1.5 million in interest cost by the issuance of the bonds before the end on 2010.

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Ms. Houston discussed Slide 13, "Department of Corrections In-State vs. Out-of-State Bed Cost Comparison," which illustrated the bed cost comparison through FY2014. She explained that the daily cost of care for an inmate was \$136.44 per day. The figure included health care and rehabilitation programs. The numbers reflected in the graph on Slide 13 stripped away all expenses but the per bed cost.

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Co-Chair Stedman requested that graph be enhanced to reflect the other costs in order to provide a holistic view of the cost comparison. Ms. Houston replied that the numbers would be revealed as the presentation moved forward.

Co-Chair Stedman remarked that that the in-state bed cost was rising faster than the bed cost out-of-state. He wondered how the other cost compared when added together.

KEVIN WORLEY, INTERNAL AUDITOR, DEPARTMENT OF CORRECTIONS, shared that DOC had been asked to compare the out-of-state versus the cost of continuing the Goose Creek project. The

department would be phasing out the out-of-state cost and adding in the Goose Creek cost. The Department of Revenue had provided the 2003-2010 numbers on the rate of return to DOC. He discussed Slide 15: "Net Present Value - Qualification and Assumptions.":

- Rate of returns for FY 2011 - 2014 are assumed to be 3%.
- Assumes capital funding was used in full the year of appropriation.
- NPV - cost of out-of-state (OOS) is estimated in order to calculate; however, the DOC will revisit it's population management plan if OOS is used for FY 2012 - 2014. Assumes population for OOS will remain at 1,050 as it is uncertain what DOC will have to do in order to house inmates in excess of 1,050.
- State will continue all bond payments.
- Assumes no additional changes to OOS contract.
- This is subject to change in the event the population management plan changes or there are significant changes to the prison inmate population.
- For NPV calculation, assumes that if GCCC is not opened, OOS inmate population will continue to increase. DOC will revisit it's population management plan.

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Mr. Worley displayed Slide 16: "Operating and Capital Expenditures, DOC Costs - GCCC Phase-in." The first line item on the Operating Budget description chart was the debt service cost beginning in FY 09. The second item illustrated the out-of-state cost from FY 03-FY 14. He pointed out to the committee that the cost was shown to go down in FY 14, but at the same time DOC would be phasing in GCCC. Line item three was the system expansion cost from FY 08 through FY 14. The last operating item was the phasing

in of GCCC following the population management program. The lower half of the chart contained the Capital Budget items. The first item was the future capital request of \$25.2 in FY 13. Four other capital projects items were listed, two related to the Department of Commerce, Community and Economic Development, and two to DOR. The total annual cost by fiscal year was presented on the bottom line. Costs for FY 13 and FY 14 were subject to change based on the prison population management plan.

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Co-Chair Stedman wondered about the pre-Goose Creek operating cost of approximately \$35 million for FY 09. He remarked that there was a jump from \$35 million in operating costs if FY 09, to \$71 million in FY 14. Mr. Worley replied that in order to figure out the operating costs the debt service cost had been added as the first line item.

Co-Chair Stedman suggested subtracting the debt service from the total operating cost. He felt this would give a clearer picture of the impact to the state of opening GCCC. He noted that the increase in operating cost from FY 08 to FY 14 was \$50 million. Mr. Worley agreed that the FY 14 operating cost was projected at \$71 million.

Co-Chair Stedman reiterated that according to Slide 16, housing prisoners in FY 08 cost the state approximately \$20 million, and would jump to \$71 million in FY 14. He noted that the department did not have significant capital costs until FY 08. He queried the plans for the \$25.2 million request listed for FY 13. Ms. Houston stated that the request represented the full furniture, fixtures, equipment, capital list start-up items, and one-time items.

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Co-Chair Stedman wondered if the numbers were located in SB 65 that reflected the \$20 million to \$71 million increase. Mr. Worley responded that if the debt service cost were removed from the projected figure for running GCCC, the total operating cost for FY 14 would be \$54.2 million.

Co-Chair Stedman probed what the cost to the state would be for FY 14, if the facility at Goose Creek was mothballed, and the prisoners remained out-of-state. Mr. Stark replied

that currently the 950 out-of-state inmates cost Alaska \$22 million to \$24 million. Ms. Houston added that calculations had been run in the past on the cost of mothballing GCCC. The \$22 million figure would include the debt service, minor utilities, maintenance staff, and private security. Co-Chair Stedman stressed that the total cost to mothball the facility was substantially lower than the projected operating cost of the facility.

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Mr. Worley discussed Slide 17: "Operating and Capital Expenditures, DOC Costs-GCCC Phase-in.", which was a graphical depiction of the information on Slide 16.

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Co-Chair Stedman asked for an explanation of Slide 18. Mr. Worley replied that slide 18: "Net Present Value (NPV) Comparison of GCCC Phase-in vs. Continuation of Out-of-State":

- NPV of GCCC phase-in = \$317.0
- NPV of Out-of-State = \$177.3

Timeframe comparison is FY03 - FY14.

Mr. Worley explained that the cash outlay of each fiscal year had been taken into account, as well as the rate of return, from FY 03 to FY 10. A rate of return of 3 percent had been assumed through FY 14.

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Co-Chair Stedman requested further explanation of the difference between the two projections. Mr. Worley replied that the cost differences were the result of the debt services the state would pay, the GCCC start-up from FY 10 to FY 14; both operating and capital requests. He added that the NPV of \$177.3 included the out-of-state costs starting at \$12.1 and rising to \$24 million by FY 14.

Co-Chair Stedman understood that the estimated cost to run GCCC was \$27 million per year, it would cost the state approximately \$400 million over 20 years. He thought that the numbers on Slide 18 underestimated the actual impact of

the cost to the state. Mr. Worley agreed. He stressed that the total value on Slide 16 for the timeframe listed was roughly \$427 million compared to the total cost of \$226.6 million for keeping inmates out-of-state.

Co-Chair Stedman offered that GCCC was an expensive project for the state.

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Mr. Mitchell discussed slide 19: "2008 Matanuska-Susitna Borough Goose Creek Bonds Security and Legal Structure.":

- Lease purchase agreement and ground lease executed in which the State leases the facility from the Borough in exchange for annual lease payments and "additional rent" equal to debt service on the bonds plus operations and maintenance costs
- -State will own the facility once the bonds are retired and lease agreement terminated
- -The Land on which the facility is constructed is currently owned by the Borough
- Right to receive lease payments assigned to trustee who acts on behalf on bond purchasers
- -State pays appropriated funds directly to the trustee five days prior to each payment date
- Lease agreement represents an absolute net lease/triple net lease in which the State is responsible for all rent payments, additional rent and operations and maintenance
- Funds for repayment of bonds are appropriated annually by the Legislature - principal payments made to the State are structured semi-annually
- Agreements are subject to early termination due to an event of non-appropriation or event of default
- -Should the Legislature fail to appropriate funds, the State may vacate the facility and be released of its obligations to make all future payments. The trustee would pursue remedies under the lease agreement including attempting to re-let the property. The State's credit rating would be downgraded.

Mr. Mitchell reiterated that the AIDEA transaction had been subject to the AMT because Valley Utilities was a private operator. Normally, water systems that were publicly owned were not subject to the AMT. There was a holiday on the AMT due to ARRA that AIDEA took advantage of which had resulted in a savings of 1.5 percent.

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Mr. Mitchell displayed Slide 20: "Financing Structure.":

- Par amount of \$244.3 million of Lease Revenue Bonds priced December 19, 2008
- Twenty-five year level debt service with a final maturity in FY 2033
- -Annual lease payment approximately \$17.8 million per year
- All in TIC 5.955391%
- Cost of issuance \$400,000, underwriting cost \$1,172,847.70 (\$4.80 per bond), cost of bond insurance \$1,105,431.27, net original issue discount \$1,533,570.95, resulting in project fund deposit of \$240,073,150.08
- Yields 35 to 100 basis points over Municipal Market Data Aaa scale of 12/19/2010
- Standard 10-year call feature

Mr. Mitchell relayed that the 2010 general obligation bonds sold in the first week of December 2010 were on top of the AAA scale. The state was upgraded to AAA prior to the transaction of the sale, which allowed the bonds to be sold into a difficult market. The state of Alaska was responsible for the lease revenue bonds.

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Co-Chair Stedman assumed that the department would make a capital request for \$25 million for FY 13. Over the last five years in the supplemental budget the committee had added approximately \$49 million, an average of \$9.8 million per year. He stressed that in-depth discussions needed to occur in committee concerning DOC expenses. He expressed

the desire to work with DOC to lower the supplemental budget numbers.

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Senator Ellis directed attention to Slide 16. He had understood during sub-committee meetings that the furniture and fixtures planned for the facility would come out of the contingency bond funds. Ms. Houston replied that DOC hoped to use up to \$5 million of the contingency bonds proceeds from the Mat-Su Borough. She said that DOC was looking to request \$1 million for telecommunications infrastructure and \$4.5 million for inmate and administrative staff furniture.

Co-Chair Stedman requested detailed reports on the construction contingency and interest reserve accounts.

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Co-Chair Hoffman wondered if the costs were even eligible. He contended that the costs should have been incorporated into the per day costs when the bonds were sold. He requested a detailed breakdown of the \$11,600 per bed cost. Ms. Houston agreed to provide the information.

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Senator Ellis felt that due to the remote location of the facility, the state was being held up for greater costs than was anticipated. He contended that he would have been reluctant to co-sponsor a bill that left the choosing of the facility location to a single community. He wondered if the remote location would result in the state incurring extra cost for transportation to medical facilities. He recognized the plan for a medical clinic on site, but expressed concern about major medical needs. Commissioner Schmidt agreed to provide that the cost estimations of transportation for medical purposes.

Co-Chair Stedman stressed that the committee hoped to achieve a comprehensive holistic view of the corrections costs to the state.

Co-Chair Hoffman made a final request for information about the developmental costs of road access. Co-Chair Stedman requested information on design, engineering, road size, et al.

Co-Chair Stedman thanked the testifiers and discussed housekeeping.

4:29:15 PM

ADJOURNMENT

The meeting was adjourned at 4:32 PM.