

SENATE FINANCE COMMITTEE
January 24, 2012
9:01 a.m.

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CALL TO ORDER

Co-Chair Hoffman called the Senate Finance Committee meeting to order at 9:01 a.m. Co-Chair Stedman discussed the agenda for the meeting.

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

David Teal, Director, Legislative Finance Division

SUMMARY

Legislative Fiscal Analyst's Overview of the Governor's FY13 Budget

^FY 13 BUDGET OVERVIEW AND FISCAL SUMMARY: LEGISLATIVE FINANCE DIVISION

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DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION (LFD), agreed with comments made by Office of Management and Budget (OMB) Director Karen Rehfeld who had discussed the governor's FY 13 operating budget the prior day. He explained that LFD agreed with the governor's presentation of the budget; the OMB fiscal summaries matched on a fund group and dollar basis. He stressed that his intent was

neither to defend nor present the governor's agenda. He would provide a technical perspective.

Mr. Teal began a PowerPoint presentation titled "Legislative Fiscal Analyst's Overview of the Governor's FY 13 Budget" and relayed his intent to look at the budget in the context of Alaska's future. He informed the committee that the LFD Legislative Fiscal Analyst's Overview of the Governor's Request for the FY 13 budget was available on the LFD website (copy on file). The book included capital and operating budget fiscal summaries and agency operating budget details.

Mr. Teal believed the LFD report contained a significant amount of good news. There was a \$3.7 billion surplus that consisted of \$1.9 billion from FY 12 and \$1.8 billion from FY 13. He relayed that the current surplus was "huge" compared to budget surpluses in past years. He elaborated that in the prior year the total FY 11/FY 12 surplus had initially been \$25 million. The FY 12 surplus had grown above \$400 million and high oil prices had increased it to \$1.9 billion. He expounded that the available \$3.7 billion surplus was over 25 percent of the \$14 billion that had been set aside beginning in 2005.

Mr. Teal shared that it was good news that the governor's operating budget growth rate was 3.2 percent and not the 7.8 percent rate that had been in place since 2005.

Mr. Teal pointed to slide 1 titled "Unrestricted General Fund Revenue/Budget." The chart illustrated what would happen if agency operating budgets continued to grow at 7.8 percent, capital budgets were \$882 million beginning in FY 13, and costs stayed flat statewide (with the exception of retirement). He discussed that under the scenario, deficits would occur beginning in 2015 and would ultimately reach approximately \$3 billion; financial reserves would be exhausted by 2025. He communicated that the 3.2 percent growth rate would result in a substantial drop in reserve declines and would come close to balancing the budget. He explained that the capital budget would not remain at \$882 million during a deficit. He provided a hypothetical scenario in which the capital budget was reduced to \$500 million, which would have helped to balance the budget.

Mr. Teal continued on slide 2: "Projected Reserve Balances." The chart illustrated how reserve balances would

be impacted by a growth rate of 7.8 percent versus a growth rate of 3.2 percent. With a 7.8 percent growth rate, reserves were rapidly depleted and would be gone by 2025; however, with a growth rate of 3.2 percent, reserves remained at approximately \$20 billion. He stressed that a growth rate of 7.8 percent was not sustainable. He communicated that the governor's budget made a strong effort to reign in the operating growth.

Co-Chair Stedman wondered if the presented status included the \$2 to \$4 billion contribution in the Public Employee Retirement System (PERS) and Teacher Retirement System (TRS); \$4 billion in equity for the construction of the Watana hydroelectric project; \$4 billion for an instate gas line; and construction of multi-billion dollar ports. Mr. Teal responded that almost none of the mentioned projects were included in the status of his presentation. He furthered that the ports might be considered part of the projection, because of a \$350 million bond issue in the governor's budget. However, that bond issue was considered future debt service.

Co-Chair Stedman pointed out that the public bond proposals for the Anchorage and Mackenzie ports did not provide enough money to complete the projects. Mr. Teal agreed, and furthered that while \$3.7 billion was considered a substantial amount of money, it would not fully pay for the Watana hydroelectric project or an instate gas line.

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Mr. Teal addressed slide 3 titled "Projected Direct State Contributions to PERS and TRS," and relayed that retirement contributions also had an impact on the future budget. He referred to the state's decision to cap the Teachers' Public Retirement System (TRS) and the Public Employees' Retirement System (PERS) at 12.56 percent and 22 percent respectively. He discussed that the state had initially believed the costs would be approximately \$200 million, that they would decline rapidly, and that it would be out of the business of state assistance by 2020 or so; however, poor investment returns beginning in 2008 had resulted in lost revenue. The losses led to revised future earnings and actuarial assumptions and an increased unfunded retirement liability of \$450 million or more in FY 12 and over \$600 million in FY 13. He elaborated that the liability would reach approximately \$800 million by FY 16 and would grow to

approximately \$1.2 billion per year in subsequent years. He emphasized the large size of the numbers and noted that current K-12 education funding was approximately \$1.2 million.

Mr. Teal informed the committee that there was some good news related state retirement costs. He explained that Alaska's system had unique characteristics that made the standard actuarial analysis obsolete. He furthered that Buck Consultants, the state's actuary, had modeled an alternative concept showing that a single \$2 billion contribution to PERS would be sufficient to fund all future benefits without additional state contributions. He communicated that the \$2 billion payment to PERS would result in a savings of approximately \$400 million per year. The state would see its \$2 billion investment returned in five years and by 2025 the savings would be above \$4.8 billion. He stressed that the total operating budget reduction would be over \$7 billion by the time the unfunded PERS liability had been paid off. Under the Buck scenario, the state would spend \$2 billion upfront, but it would have more reserves in 2025 than it would if it continued to make annual contributions.

Co-Chair Stedman wondered if it were possible to include \$2 billion for PERS and \$1 billion for TRS, in order to observe their effect on the budget. Mr. Teal responded that if the money for PERS and TRS were included, the savings would be about half of what was represented. He stated that retirement was a big "driver" in the budget, and contributions would become a big problem when looking at a deficit.

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Mr. Teal discussed reasons LFD analysts were pessimistic about the future on slide 4 titled "FY 12/13 General Fund - Fiscal Sensitivity Overlay." He explained that the revenue curve was dependent on price of oil; however, each year as production declined the revenue curve shifted downward. The curve was approximately \$900 million less in FY 13 than it had been in FY 12 under any given price of oil; with oil at \$95 per barrel revenue was approximately \$7 billion in FY 12, but it was under \$6 billion in FY 13. Production decline would lead profit loss due to lower tax revenue combined with higher capital and operating costs. The revenue curve would shift downward and the breakeven price

of oil would continue to increase; the breakeven rate had been \$94 per barrel in FY 12 and would be approximately \$100 per barrel in FY 13. He added that the revenue curve shown on slide 1 took the declining production into account. The decline was partially offset by the increased price of oil.

Mr. Teal relayed that the second issue was related to the governor's proposed 3.2 percent agency operations growth rate, which would be difficult to achieve. He expressed skepticism about the plausibility of the proposed \$882 million capital budget. He believed it would be hard to stay at the proposed level because there were several items missing from the budget. Education funding for K-12 was flat from the prior year's budget and typically every \$100 increase in the Base Student Allocation (BSA) cost \$25 million; school boards had discussed a \$300 increase in BSA, which equated to approximately \$75 million. The Alaska Gasline Inducement Act (AGIA) had been short funded by approximately \$100 million. He communicated that the fuel trigger was at the same level as the prior year and stopped at \$100; however, the projected price of oil was \$109 per barrel. Extending the fuel trigger up to the projected price of oil would cost approximately \$9 million. Additionally, the proposed budget did not include \$3.5 million in actuarially required Judicial Retirement System (JRS) contributions.

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Mr. Teal discussed that a number of funds spent more than they brought in including, fish and game, oil and hazardous, worker's safety, Alaska Marine Highway System, the Department of Natural Resources land disposal, and others. He discussed that agencies typically had to request additional general funds when their normal fund source was depleted. A solution to the structural problem could take up to \$20 million for a one-time fix and significantly more for a longer term solution. Unlike other states, Alaska did not have sales and income taxes to fix the bulk of its revenue problems. Alaska currently depended on oil revenue; however, the resource-generated revenue only lasted as long as the resource itself. He communicated that without additional oil production the state would be forced into watching its revenue decline. He compared the state to an individual near retirement who would have to rely on savings.

Mr. Teal emphasized that increased current savings improved the likelihood that the state could avoid income and sales taxes and losing the Permanent Fund Dividend in the future. He did not believe the FY 13 budget process would involve dissecting the governor's increments because there were not many increments on a department-by-department level. He thought the budget process would focus on the decision to spend versus the decision to build reserves. He believed that the combined importance of the revenue and expenditure decisions made the FY 13 budget cycle critical to Alaska's future.

Co-Chair Stedman wondered what would happen if \$4 billion for the Watana hydroelectric project; \$4 billion for the instate gas line; \$1 billion for the ports; and \$2 billion for TRS were included in the projection. Mr. Teal replied that if \$11 billion were taken out of the reserves, the savings would remain virtually "flat." He remarked that he could not accurately calculate the projection, because his program displayed the retirement funding as incorrect.

Co-Chair Stedman wondered if the \$11 billion for the projects and retirement funding could be included in future presentations of projections. Mr. Teal agreed to provide that information.

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Senator Thomas surmised that the \$3.7 billion determination was concluded because of the addition of and unanticipated oil revenue increase of \$1.9 billion from FY 12, and additional \$1.9 from FY 13. Mr. Teal replied that at the end of the prior session the legislature had left \$400 million of FY 12 spending "on the table." He added that the FY 12 surplus had grown since the April prior, because the price of oil had increased substantially from \$400 million to \$1.9 billion. The FY 13 projection had oil at \$109 a barrel for continued prices. He pointed out that the result was approximately \$900 million left in revenue, however the governor's budget was several hundred million lower than that on the capital side. He stressed that there would be a surplus of \$1.8 billion in FY 13, for a total of \$3.7 billion.

Senator Thomas looked at the Alaska Gasline Inducement Act (AGIA) shortfall and the K-12 flat funding, resulted in

\$600 million. Mt Teal state replied that it would be closer to \$200 million.

Senator McGuire inquired the location of the offset of earnings from Alaska's investments. Mr. Teal responded that the reserves were first taken from the Alaska Housing Finance Corporation (AHFC) account; when that account was emptied, the money was taken from the Statutory Budget Reserve (SBR); and then the money was taken from the Capital Budget Reserve (CBR).

Co-Chair Stedman asked if the Permanent Fund was taken into account, after the CBR was emptied. Mr. Teal replied in the affirmative, but stressed that his current focus was only on the AHFC, SBR, and CBR. He pointed out that the Permanent Fund was an undesignated savings account, so the money could be spent however the State wanted. However, that step had never been taken.

Co-Chair Stedman declared that he did not want to rely on the Permanent Fund as reserves.

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Co-Chair Stedman thanked Mr. Teal for his presentation, and stated that he wanted to see dialogue that included capital projects. He continued to discuss housekeeping.

Senator Olson wondered when a hearing when be held on the large capital projects. Co-Chair Stedman stated that he wanted to get a holistic view of the capital projects and get "everything on the table at once", before discussing the larger projects in detail. He announced that the committee needed to decide how to prioritize the State's expenses.

Co-Chair Stedman discussed the agenda for the following meeting.

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ADJOURNMENT

[9:39:46 AM](#)

The meeting was adjourned at 9:39 AM.