

HOUSE FINANCE COMMITTEE
January 24, 2013
1:31 p.m.

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CALL TO ORDER

Co-Chair Austerman called the House Finance Committee meeting to order at 1:31 p.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Bryce Edgmon
Representative Les Gara
Representative David Guttenberg
Representative Lindsey Holmes
Representative Cathy Munoz
Representative Steve Thompson
Representative Tammie Wilson

MEMBERS ABSENT

Representative Mark Neuman, Vice-Chair
Representative Mia Costello

ALSO PRESENT

Michael Hanley, Commissioner, Department of Education and Early Development; Mark Lewis, Director, Administrative Services, Department of Education and Early Development; Bryan Butcher, Commissioner, Department Of Revenue; Dan Stickel, Assistant Chief Economist, Tax Division, Department of Revenue; Bruce Tangeman, Deputy Commissioner, Tax Division, Department of Revenue; William Barron, Director, Division of Oil and Gas, Department of Natural Resources; Angela Rodell, Deputy Commissioner, Treasury Division, Department of Revenue.

SUMMARY

FY 14 GOVERNOR'S BUDGET OVERVIEW:

Department of Education and Early Development

Alaska Revenue and Price Forecast: Department of
Revenue and Department of Natural Resources

HB 65 APPROP: OPERATING BUDGET/LOANS/FUNDS

HB 65 was HEARD and HELD in committee for further
consideration.

HB 66 APPROP: MENTAL HEALTH BUDGET

HB 66 was HEARD and HELD in committee for further
consideration.

#hb65

#hb66

HOUSE BILL NO. 65

"An Act making appropriations for the operating and
loan program expenses of state government and for
certain programs, capitalizing funds, amending
appropriations, and making reappropriations; and
providing for an effective date."

HOUSE BILL NO. 66

"An Act making appropriations for the operating and
capital expenses of the state's integrated
comprehensive mental health program; and providing for
an effective date."

^FY 14 GOVERNOR'S BUDGET OVERVIEW: DEPARTMENT OF EDUCATION
AND EARLY DEVELOPMENT

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MICHAEL HANLEY, COMMISSIONER, DEPARTMENT OF EDUCATION AND
EARLY DEVELOPMENT (DEED), introduced department staff. He
provided a Power Point presentation titled "State of Alaska
FY 2014 Governor's Operating Budget: Department of
Education and Early Development." He explained that the
parameters of education services in Alaska were defined by
its constitution, which designates that the legislature
shall by general law establish and maintain a system of
public schools for all children in the state (slide 2). The
core system had defined key functions that enabled the
establishment and maintenance of public schools including
providing adequate funding, oversight and support, setting

student standards, and assessing students on their progress towards proficiency in meeting the standards.

Commissioner Hanley communicated that the education policy is defined in statute, which stated that the purpose of education is to help ensure that all students will succeed in their education and work (AS 14.03.015). He read the department's four core services on slide 3:

1. Public School Funding - Ensure funding is appropriately distributed to recipients based on legislative appropriations and by Statute.
2. Fiscal Accountability, Compliance, and Oversight - Ensure the department effectively and efficiently manages state, federal and other funds.
3. School Effectiveness Programs - Assist districts by providing programs, technical on-site and distance delivery support, and early intervention services.
4. Active Partnerships - Provide opportunities for, and collaborate with government entities, and other public and private organizations.

Commissioner Hanley elaborated that funding could be provided by grants and formula programs. He added that DEED worked directly with districts to [effectively and efficiently] manage funding. He added that the state and department did not have authority to make decisions at the local level related to curriculum, personnel, and other; the items were set at the local level by school boards and personnel. He moved to a pie chart on slide 4 that illustrated the DEED budget by core services: 80 percent went to public school funding; 14 percent went to accountability, compliance, and oversight, which included assessments; 2 percent went to school effectiveness programs including State System of Support programs, mentors, and WorkKeys; and 4 percent went to active partnerships.

Commissioner Hanley addressed a graph on slide 5 related to school effectiveness and the statewide graduation rate goal. He relayed that graduation had always been one of DEED's core functions. He stressed that the department viewed graduation as a destination it needed to help students reach in order to adequately prepare them for the

next step in their lives. He shared that the governor had recently set a 90 percent graduation rate goal to be achieved by 2020; the actual rate had been 68 percent in 2011 and 69.6 percent in 2012.

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Representative Wilson wondered how the state and department could help increase graduation rates to 90 percent if all of the action was taken at the local level. Commissioner Hanley replied that local decisions were not the only piece of the equation. He shared his intent to address the question further on the following slide.

Commissioner Hanley pointed out that the graduation rate was a cohort and not an annual rate; the measurement began when students entered ninth grade and tracked how many of the students graduated in four years.

Co-Chair Austerman asked committee members to hold their questions until the end of the presentation.

Commissioner Hanley continued to discuss how graduation rates were determined (slide 5); all states utilized the same method. Slide 6 addressed the governor's proposed increment for the Jobs for Alaska's Graduates program (JAG). The proposal was based on a national model used by 33 other states; it had a 93 percent graduation rate for at-risk students. The program would identify and engage at-risk students, set time for them on a daily basis, work to help them obtain the credits needed to graduate, work with them on employability skills, connect them employers, help them to overcome barriers, stick with them through the summers, guide them into jobs, and stick with them for 12 months after graduation. The proposal would put eight or nine specialists in different locations who would work with 35 to 45 students a piece.

Commissioner Hanley turned to a chart on slide 7 related to DEED's active partnerships with the Alaska Commission on Postsecondary Education (ACPE). The blue bar represented the total graduation rate; the 2012 graduate cohort was smaller than the one in 2011 due to a decrease in enrollment. The red bar represented the number of students who qualified for the Alaska Performance Scholarship; 29 percent qualified in 2011 and 28 percent qualified in 2012. The green bar represented the number of students who took

advantage of the scholarship; 12.8 percent of qualifying students used the scholarship in 2011 compared to 10.7 percent in 2012. The comparison did not provide a complete look at the overall picture given that students had two years to access the scholarship after qualifying. He elaborated that some students in the 2011 cohort had left the state for a year and had then returned to access the program; therefore, DEED anticipated that numbers would rise for 2011 and 2012.

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Commissioner Hanley spoke about the governor's proposed increment for digitizing education in Alaska on slide 8. He pointed to several components of the proposal including a "1:1 initiative." He detailed that the initiative was not about matching technology to students, but about changing and providing better access for opportunities to students and meeting students' needs. The initiative would allow teachers to become more efficient by using the tools to measure student growth. The initiative was about putting devices into the hands of each student in order to ensure that they had the latest technology skills.

Commissioner Hanley discussed the Alaska Learning Network as another piece of the governor's goal to digitize education in Alaska. A portion of the network was currently in place; it connected high quality teachers and online courses to students around the state. He provided an example of an Introduction to Mining course that had started during the current week; 120 students statewide were anticipated to participate in the current course. He detailed that the course was a partnership with the University of Alaska that provided dual credits with the mining companies throughout the state. Greens Creek Mine in Southeast was a primary supporter of the program and was helping to pay student fees; students were only responsible for \$44. The mines were looking for local hires, given the lower turnover rate; the goal was to aim students for a local workforce. Greens Creek had also committed to offering a summer internship to students in the top one-third of the class that would pay \$12,000; students would then have the opportunity to have some of their college tuition paid. He emphasized that every student would have the opportunity to tour a mine in their region. The program applied to the entire spectrum of occupations that fell

within the mining sector including environmental engineers and other.

Commissioner Hanley pointed to broadband support as the third component of the governor's emphasis on digitizing education in Alaska (slide 8). The effort was conducted through the state's libraries and museums partnership called Online with Libraries (OWL). Infrastructure capabilities were available in 67 community libraries; continued support would be provided to maintain broadband access. He furthered that 30 of the 67 libraries were school libraries. The capability allowed college-aged students to access courses, adults to access state services, and communities to connect with each other for joint meetings.

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Commissioner Hanley relayed that the final component of the governor's plan to digitize education in Alaska was live homework help (slide 8). The program offered tutoring help from 1:00 p.m. to 12:00 a.m. 7 days per week. The number of students using the service had grown from 5,703 to over 8,000. He shared that the student representative on the state school board came from a small school in Port Heiden; the program allowed her to access help with algebra that her local teacher was not able to provide.

Commissioner Hanley addressed efficiency measures on slide 9. He explained that the agency portion of the \$5,680 Base Student Allocation (BSA) was \$129.15 per student; the funds paid for support services including mentoring and other. He turned to a DEED organizational chart on slide 10. The Alaska State Board of Education and Early Development was the head of DEED; membership was composed of 7 members who represented the state's 4 judicial districts, 3 at-large members, and 1 member who represented an REAA [Regional Educational Attendance Area]. He elaborated that the three components at the bottom of the chart represented the department's active partnerships including the Professional Teaching Practices Commission, Alaska State Council on the Arts, and the Alaska Commission on Postsecondary Education (each entity had its own organizational structure and boards and commissions).

Commissioner Hanley stated that the DEED budget was broken into two components (slide 11): (1) K-12 formula programs in the amount of \$1.386 billion and (2) agency operations in the amount of \$311 million; the total budget was \$1.69 billion. A pie chart showed the operating budget by fund source: 85 percent general funds, 14 percent federal funds, and 2 percent other funds (e.g. interagency receipts). He turned to a chart showing the department's total fund operating overview (slide 12): 94 percent of funds were spent on grants to schools (e.g. foundation formula, pupil transportation, school debt reimbursement, and Title 1 programs); 4 percent of funds were contractual (e.g. assessment, commodities, and travel); and 2 percent of funds went to personal services.

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Commissioner Hanley relayed that the department had 335 full-time positions, which included staffing for the state run boarding school Mount Edgecumbe, the Professional Teaching Practices Commission (PTPC), the Talking Books Library, ACPE, and other (slide 12). Slide 15 included a pie chart depicting an overview of the department's operating budget: 82 percent went to K-12 formula programs and 18 percent went to agency operations. Slide 14 showed agency operations by fund source: 24 percent in general funds; and 68 percent in federal funds. He emphasized that agency operations were largely funded with federal dollars.

Commissioner Hanley directed attention to budget highlights on slide 15. He stated that the governor recognized that state revenues were decreasing and had put forward a fiscally conservative budget; however, several additional increments had been added to the department's budget including funding for school district support outside of the formula, forward funding for the Foundation Program and pupil transportation, and funding for the Autism Resource Center and Rural Transition Services (per the recommendation of the Alaska Mental Health Trust Authority).

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Commissioner Hanley discussed additional funding proposals on slide 16. The administration recognized the importance of children being able to read by the third grade. The statewide K-3 Literacy Program would focus on early

identification and would provide a universal screening tool for kindergarten through third grade that would enable teachers to recognize and address any deficits in students' reading. The program did not address deficits, but provided teachers with the information to make the necessary teaching decisions to help students. He explained that previously \$800,000 for Pre-K grant funding had been moved to one-time funding; the proposal was to move \$480,000 back into the base. Two other funding increments would go to the JAG program and the digitizing of Alaska's education system.

Commissioner Hanley communicated that DEED had incorporated its budget changes into the 10-year plan. Using data from the past several years DEED projected flat funding of the foundation formula, which included \$25 million outside the formula as targeted funding. He noted that 10-year projections were "crystal ball exercises" given that it was hard to determine the future. Projected operating costs included inflation adjustments for contractual obligations.

Commissioner Hanley addressed capital projects on slide 18. He detailed that construction and major maintenance items remained at current levels. The proposed budget included funding for one school construction (based on the Kasayulie settlement) and continued funding for a previously supported project. The department had moved down 14 projects on its major maintenance list. The budget also included maintenance for Mount Edgecumbe based on its 6-year plan to keep the school in operation and funding for the Stratton library the state had acquired in Sitka. Slides 19 and 20 illustrated the 10-year projection in graph form. The dotted black line represented DEED's projection and was relatively flat. The green line represented what would occur if the department's budget continued to grow at a 10.5 percent annual growth rate. He believed a realistic growth rate would fall somewhere between the two lines. He emphasized that the department's budget was a part of a fiscally conservative total state budget that did not grow at 10.6 percent. He believed the governor recognized that a 10.6 percent annual growth rate would be unsustainable. The graph on slide 20 represented the 10-year projection for all funds.

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Commissioner Hanley continued to discuss slide 20, which showed a target of 4.8 percent annual growth; the target was slightly higher than actual growth that had occurred in the past five to six years. The graph showed a flatter projection than 4.8 percent, but he anticipated the actual budget would fall somewhere between the two projections. Slide 21 showed the DEED budget compared to all other agency budgets (non-formula and general fund only). The DEED share had been consistent at approximately 2 percent beginning in FY 07; it had been at 1.6 percent in FY 05. Slide 22 provided the DEED formula and non-formula funding compared to other state agencies. He pointed to the trend line (shown in blue) that had decreased from 29.7 percent in FY 05 to 25.5 percent in FY 14. He stressed that department's portion of the total budget had been steadily declining over the last several years.

Co-Chair Austerman pointed to slide 19 and asked for verification that DEED expected "somewhat" of an increase over the next several years in general fund spending. Commissioner Hanley responded in the affirmative.

Co-Chair Austerman asked if the growth was due to salary increases or other.

MARK LEWIS, DIRECTOR, ADMINISTRATIVE SERVICES, DEPARTMENT OF EDUCATION AND EARLY DEVELOPMENT, responded that salary increases were not included in the department's 10-year plan; the Office of Management and Budget (OMB) was responsible for trending salaries. The graph only showed increments contained in the DEED 10-year plan.

Co-Chair Austerman asked for detail on increments that were responsible for the department's projected general fund spending growth. Mr. Lewis replied that the "modest" growth was due to items such as contractual increases for the state assessment system, mentors (growth of 2.7 percent), and other.

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Representative Munoz queried how graduation rates tracked students who moved from one district to another during high school or who began high school in Alaska and moved out of state prior to finishing.

Commissioner Hanley answered that there was a statewide identification system for K-12 that allowed DEED to track when a student left one district and enrolled in another. He explained that it became challenging when students moved out of state, but the system did recognize when students enrolled elsewhere and worked to create a realistic picture.

Representative Thompson asked for verification that the 69.6 percent graduation rate included students who entered 9th grade and graduated in four years. Commissioner Hanley replied in the affirmative.

Representative Thompson asked how students who graduated in over four years were accounted for. He wondered how the data skewed the graduation percentages. Commissioner Hanley opined that every graduate represented a success story. He responded that those graduating in more than four years would add approximately 1 percent to 2 percent. He furthered that the state used the specific formula because it allowed DEED to compare Alaska's graduation rate to those in other states.

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Representative Guttenberg asked whether the growth charts accounted for fluctuating student enrollments, costs of heating, transportation, or other. He wondered what was built into the figures.

Mr. Lewis replied that the growth had been trended out. The department based future projections on current year forecasts because it was the only basis it could use to make a decision on; it did not try to calculate any increase or decline in student population.

Representative Holmes referred to the department's 10-year plan. She urged the department to work on a way to develop a more realistic future projection that could be used as a planning tool. She observed that the 10-year forecast looked remarkably flat. She pointed out that there would be increases in inflation and other.

Representative Gara referenced slide 17 and asked if the \$25 million in funding outside of the BSA would be an annual increment or if it would build on itself by \$25 million annually.

Commissioner Hanley replied that the figure was an annual increment of \$25 million; the 10-year projection included the amount as a reflection of recent years but it was not reflective of a "wish list" or suggestion.

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Representative Gara looked at slide 19 and wondered if DEED could provide a better estimate on its future budget growth.

Commissioner Hanley replied that it was difficult for DEED to provide future projections because working with the legislature determined what the number would be. He furthered that the projection would continue to look similar if the BSA of \$5,680 and the annual appropriation of \$25 million remained static going forward.

Representative Gara wondered how DEED planned to increase student achievement given cuts that had been made. He pointed to two years of flat education; no BSA increase; and, the Anchorage school district was laying off teacher aides, tutors, and student counselors in Anchorage who were helping students transition to college and jobs; and summer school in Anchorage had been closed the prior year.

Commissioner Hanley answered that flat funding meant that no money had been added to the BSA, but it did not mean that education had received no funding increase in the past years. He expounded that the \$25 million increment had been provided for the first time the prior year, money had been added to Career and Technical Education (CTE), and the state had allocated money to the Teachers' Retirement System (TRS). He reiterated that the governor's proposed budget included funding for energy and other; however, he recognized that whether the budget kept up with what districts needed was a different issue.

Representative Gara appreciated the effort to increase reading proficiency in the K-3 Literacy Program; however, he thought Commissioner Hanley had testified in the past to the importance of working with children on literacy by the ages of 3 and 4. He wondered why the Literacy Program was not starting at the Pre-K level.

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Commissioner Hanley did not recall the testimony. He stated that the Literacy Program would strengthen the current school system. He elaborated that there was funding for some Pre-K programs, Parents as Teachers, Head Start, Best Beginnings, and other. There was not a system wide Pre-K program in place, but DEED believed that when children entered the school system it was important for teachers to understand each child's specific needs to ensure readiness for reading by the third grade.

Representative Wilson queried whether the state was seeking a waiver related to No Child Left Behind. She wondered how the waiver would impact the state's federal funding.

Commissioner Hanley replied that the waiver from No Child Left Behind should not have an impact on federal funding; however, it would change the measurement and accountability tools. The department believed the shift would more accurately measure what took place with students in Alaska.

Representative Wilson discussed that district's had local control over how they spent BSA money. She believed programs continued to be added and surmised that it was because the department was not seeing the necessary growth. She wondered why districts were not charged for elective programs and why the funds were not coming out of the BSA.

Commissioner Hanley asked for verification on the question.

Representative Wilson clarified her question. She pointed to digital learning as an example; not all districts would access the same programs based on their individual needs. She wondered why the various elective programs were not charged to the BSA. She thought that districts should pay for their participation in the programs instead of the state providing a free service.

Commissioner Hanley responded that DEED had some explicit proposals to move forward with. He stated that the department was looking at "specific targets for specific outcomes." He stressed the importance of local control for districts to address their needs. He addressed graduation rates and believed that implementing a targeted program would provide a targeted outcome. He communicated that it was "a categorical specified funding for something that the governor wants to see."

Representative Wilson asked if the department could specify targets for districts that would allow DEED the authority to redirect or change programs in specific districts if the targets were not met. She stressed that the budget did not include enough money for all of the districts.

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Commissioner Hanley replied that the JAG program was the only program that would begin in select districts; other programs were all statewide. He guessed the state could implement regulations that put responsibilities on districts without funding them; however, he pointed out that a new set of content standards had been implemented and that the rigor had been tremendously increased related to expectations for students. The department had not funded districts to replace their curriculum or do professional development; it was a burden for districts to move in the new direction, but it was an expectation the department had. He expounded that teacher evaluations were now tied with student learning; funding had not been tied to the new requirement, but DEED wanted to see high quality teachers in the classroom. He noted that the department was working to support teachers and that only so much could be asked of them without providing additional funding.

Representative Wilson was concerned about the fairness of some "excellent" districts operating on a set amount of funding while challenged districts were receiving added programs. She opined that the challenged districts were getting the BSA and programs on top of that, whereas other excellent districts were "trying to survive on a string." She wanted to ensure that districts with excellent schools were taken care of as well. She would discuss the issue further during the DEED Finance Subcommittee meetings.

Representative Guttenberg pointed to digitizing education (slide 8). He asked about current capability to provide all schools with bandwidth. He pointed to constant growth in the demand for increased capacity to account for the growing number of computers, iPads, and other. He observed that currently bandwidth capacity was fairly limited. He mentioned the state's broadband task-force. He wondered whether the department would be able to keep up with the ever increasing demand for bandwidth.

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Commissioner Hanley believed that broadband would always be maxed out. The digitization initiative did not require broadband in every capacity. He relayed that every school district had broadband, but every district did not have the ability for all of its students to be online at the same time or the ability for live-streaming. Under the digital initiative districts would build a plan around their existing capacity. He pointed to recent funding for the Association of Alaska School Boards (AASB) for student use of iPads; he stated that "tremendous growth" had been witnessed for K-3 graders who had participated in the program. He elaborated that most of the iPads used "apps" (applications) and did not have access to broadband. He relayed that DEED did not have significant capacity to push forward broadband. He referenced that DEED was watching and supporting GCI's TERRA project [a project working to provide broadband connection to rural communities throughout Alaska]; broadband access was now available in Hooper Bay. He shared that DEED was looking at obtaining the best e-rate in order to keep costs down. He recognized the challenge and believed the department could move forward with the current capacity; the capacity could continue to be increased when available.

Representative Guttenberg was concerned that broadband learning opportunities were equalizers for rural and urban communities and students with different ways of learning. He wanted to ensure that students had equal learning opportunities that would help them succeed in school and life.

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Representative Munoz believed the mining training program was a great partnership between multiple entities. She wondered whether the program could act as a model for other sectors including healthcare, marine technology, and other.

Commissioner Hanley replied that he hoped so. The mining program connected industry with the education system to help provide training and high paying jobs to Alaskans; it was the first of its kind that the department had participated in.

Representative Gara had been told by school officials in Anchorage that the rate for school districts' ability to

make local contribution had been capped too low when the legislature had worked to make local contributions more equitable the prior year. He had heard from officials who wanted to contribute more. He wondered if there was a solution to the problem.

Commissioner Hanley responded that he did not believe a mistake had been made, but the local contribution rate had been changed. He explained that Anchorage's contribution needed to be \$8 million less and the state had picked up \$8 million more. He added that criteria existed related to how much could be contributed. He had been involved in meetings the prior summer with the Anchorage Chamber of Commerce and the school district related to the issue. He opined that there were ways for communities to adequately contribute.

Representative Gara asked if the department supported the concept of Pre-K programs. Commissioner Hanley recognized that early intervention programs could benefit students and prepare them for kindergarten.

Co-Chair Austerman referenced the department's 10-year budget projection on slide 19. He stressed that legislators and department administrators had to think beyond the next several years or the state could end up in a bad situation. He expressed concern about the 10.5 percent projected annual growth figure on slide 19 and stated that if it was accurate there were some "real problems" that needed to be planned for. He elaborated that there was no way to plan for the future if departments continued to come forward with one or two years of anticipated growth. He hoped the administration would recognize the importance of providing a realistic 10-year plan.

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Commissioner Hanley replied that the department could work with key legislators to help it come up with a more realistic plan.

Co-Chair Austerman remarked that population growth alone would account for higher budget increases than those included in the department's annual management plan on slides 19 and 20.

^ALASKA REVENUE FORECAST: DEPARTMENT OF REVENUE and DEPARTMENT OF NATURAL RESOURCES

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BRYAN BUTCHER, COMMISSIONER, DEPARTMENT OF REVENUE (DOR), provided a Power Point presentation titled "Overview of Fall 2012 Revenue and Price Forecast." He looked at an outline on slide 2 and shared his plan to discuss the department's 10-year overview, total revenue (including oil and non-oil revenue). Slide 4 showed a snapshot of DOR's 10-year revenue forecast. He pointed out that the department's forecast included an expectation of relatively high oil prices into the future. The yellow row titled "Total ANS Production" showed production levels that would continue to decline (production had been declining in recent decades); as a result the general fund unrestricted revenues were projected to decrease as well.

Commissioner Butcher directed attention to slide 5 that provided a detailed look at the differences between the department's spring 2012 and fall 2012 forecasts. He relayed that the price of oil was down by approximately \$1.77 from the spring 2012 forecast; production was also down by approximately 10,000 barrels per day. He stated that in conjunction with increased North Slope expenditures revenue was down by approximately \$928 million from the spring forecast (higher spending was taken out prior to the calculation of production tax value; corporate income tax was also off slightly). There was a slight uptick in the oil price forecast and a more "severe" production decline (by approximately 29,000 barrels). The production decline was largely due to delayed production in some wells and reduced performance in some other wells.

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Commissioner Butcher added that the fall forecast was approximately \$1.6 billion less than the spring projection. He reiterated that the reduction was due to lower production and oil prices and higher spending. He addressed slide 6 titled "Total Revenue Forecast" that included unrestricted and designated general funds, other restricted revenue, and federal revenue. He pointed out the FY 12 actual investment revenue at \$109 million compared to the forecasts for FY 13 and FY 14 that were over \$3 billion each. He explained that the Permanent Fund had high earnings in FY 11, but that FY 12 investment revenue was virtually flat. The projections for FY 13 and FY 14 were

based on what the Permanent Fund expected to make; the fund was up approximately 7 percent for the first 6 months of FY 13. He stated that the fund was "well on its way" to achieving the FY 13 forecast.

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Commissioner Butcher pointed to a table that broke down unrestricted general fund revenue particularly related to petroleum revenue; it detailed what the state receives in royalties minus royalties designated for the Permanent Fund and Public School Fund. The production tax represented the largest portion of incoming revenue; corporate income tax accounted for \$568 million; and property tax was generally around \$100 million. Slide 8 provided a snapshot of non-oil revenue. He relayed that over 90 percent of the state's budget was paid for with oil revenue; therefore the non-oil revenue represented a relatively small portion of the total picture at approximately \$627 million. The slide also included a detail on the various taxes including corporate income, mining license, insurance premiums, tobacco, motor fuel, and other smaller taxes. The department did not foresee a tremendous change between the last, current, and upcoming fiscal years.

Commissioner Butcher addressed a chart depicting the production history and forecast on the North Slope (slide 9); production had peaked in the late 1980s at 2.1 million barrels per day. Slide 10 included a closer look at oil producing fields from 2002 to 2022 including Prudhoe Bay, Prudhoe Bay Satellites, Kuparuk, Endicott, and other. He noted that legacy oil fields of Prudhoe Bay and Kuparuk were still expected to produce the most oil over the next ten years. He looked at oil price forecast methodology on slide 12. He shared that the past fall marked the fifth or sixth year that DOR had held an all-day forecasting session. The most recent session was on October 2, 2012; there had been 31 participants from DOR, Department of Natural Resources, Department of Labor and Workforce Development, OMB, University of Alaska, Institute of Social and Economic Research, Legislative Finance Division, and other outside entities. He elaborated that experts were brought in and the entities considered supply, demand, geopolitics, financial markets, and other expert forecasts (e.g. federal Energy Information Agency (EIA), New York Mercantile Exchange (NYMEX), futures market, and other). He furthered that experts were brought in to present at the

meeting in order to encourage a more interactive dialogue on what was occurring worldwide. He shared that DOR had heard from Barry Pulliam of Econ One, the late Dr. Tony Finizza (former chief economist of ARCO), Samuel Van Vector, President of Economic Insights, and the Wells Fargo senior economist Mark Vitner. The forecasts from participants were blended with EIA and NYMEX and other analysts to determine the DOR fall forecast.

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Commissioner Butcher moved to slide 13 that showed the price of oil for the past five years and price forecasts through FY 17. The slide included price forecasts from multiple entities; EIA had a "rosier" or bullish outlook than others and NYMEX was forecasting at the lower end of the spectrum; however, most analysts tended to see prices in the middle range. He pointed out that DOR's projection fell "comfortably" in between the high and low forecasts. He communicated that rating agencies look at all aspects of the revenue projections to determine how realistic they are. For example, a state could use a state income tax that was higher than rating agencies believed would occur, which would give a rosier view of forecasted state revenues. He furthered that ratings agencies worked to determine how conservative or optimistic projections were; he stated that conservative projections were better. He shared that ratings agencies had acknowledged that the department's price forecast had been lower than the actual forecast in five of the past six years; however, its production forecast had been overly optimistic every year for the past couple of decades.

Commissioner Butcher shared that slide 14 titled "General Fund Unrestricted Revenue Price Sensitivity FY 2013-2015" had been included for future reference; it showed the forecasted revenue, production, and price (price could fluctuate tremendously). The slide depicted what the state would generate in revenue at different per barrel costs beginning at \$50 dollars and increasing by \$10 increments; it showed how a price swing up or down would impact revenue. He observed that there was a fairly extreme difference between the scenarios due to the progressivity of the current production tax system.

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Co-Chair Austerman pointed to a breakdown of unrestricted non-oil taxes on slide 8 and asked for a brief description of other taxes.

DAN STICKEL, ASSISTANT CHIEF ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE, answered that the other taxes were all unrestricted taxes. He explained that the table on slide 8 included line items for the top five taxes. He pointed to the department's fall 2012 Revenue Sources Book (page 54) that listed other unrestricted taxes for items including alcohol, fisheries, charitable gaming, vehicle rental, and other.

Representative Gara referred to a January 21, 2013 presentation specifying that one of Moody's factors for rating the state highly was that it used a conservative approach to forecasting oil revenues with respect to both price and production. He observed that DOR's projection was below the middle mark on slide 13 and wondered whether it was what Moody's was referring to and what the department was aiming for.

Commissioner Butcher replied that slide 13 was related only to price forecasts; DOR's forecast was a result of equally blending projections from multiple entities. He furthered that Moody's based its view on the fact that DOR's forecasts were consistently lower than actual prices turned out to be. He explained that if DOR based its forecast on EIA it would be much more likely to have an overly optimistic price projection compared to actual.

Representative Gara asked for verification that the price forecast had been slightly under what actual numbers had been in five of the past six years. Commissioner Butcher replied in the affirmative.

Representative Gara understood that the state did not want to overestimate how much money it would have to spend; however, he wondered if the price estimates were being used in the fiscal notes for the current oil tax legislation. Commissioner Butcher replied in the affirmative. He relayed that the fiscal notes were based on the department's fall 2012 forecast.

Representative Guttenberg had read that the federal government was looking at making changes to mining royalty

rates. He wondered if the state may be able to take a percentage if royalty rates were increased.

[2:46:32 PM](#)

Commissioner Butcher asked for clarification on the question.

Representative Guttenberg restated that the federal government was reexamining royalty rates and that some states got a larger cut for offshore oil or gas production. He did not want to increase rates above what the federal government would implement, but surmised that the state could take a portion of the revenue. Commissioner Butcher answered that the issue was under the purview of the Department of Natural Resources (DNR).

Representative Guttenberg wondered how a pipeline shutdown in 2012 had impacted production compared to other years. He asked why the shutdown had been longer than expected. Commissioner Butcher confirmed that the main reason for the 10,000 barrel per day decrease was due to the shutdown. He did not know if issues had prolonged the shutdown. The department would follow up on the question.

Representative Guttenberg asked for a status on the auditing of past tax reports. Commissioner Butcher replied that audits had been completed for the first year of the Petroleum Production Tax (PPT); it was currently in the PPT/Alaska's Clear and Equitable Share (ACES) year, which had come in in 2008. The department expected the audit to move increasingly faster given that it had finished the transition from gross to net. He pointed to vacant auditor positions as a primary problem and relayed that the positions had been filled; the proposed FY 14 also included a request for two auditor positions. The department was statutorily in a fine position related to the audits, but it would like to get further along.

[2:49:18 PM](#)

Representative Guttenberg asked whether a report on the audits would be available. Commissioner Butcher responded that there had not been a substantial difference in the audits. The department would be happy to brief the committee or provide a confidential briefing at a later time.

Co-Chair Stoltze remarked that it may be helpful for DOR to be present at department budget presentations to instill recognition of the current situation related to revenue and oil production. He pointed to the challenges of running a pipeline under lower oil flow conditions. He asked the department to be mindful of what oil meant to the state's budget; he observed that mining revenue would not "even cover" the operational costs of the Department of Education and Early Development and fish taxes would not fund a three-year Chinook study in the amount of \$30 million.

Commissioner Butcher discussed why DOR had decided to dig into the way its production forecast was produced. He recalled that in the past committee members had expressed dissatisfaction over DOR's long-term production forecast. As a result the department had looked at the issue to determine how to increase accuracy in its forecasting; it discovered that the forecast had been high by 40 percent to 65 percent in its 10-year production forecast. He shared that historically the decline rate had been 6 percent, but DOR had projected an annual decline rate of no higher than 2.5 percent (many years the projection had been lower than 2.5 percent). He stated that clearly the process had not been accurate and needed to be improved. Subsequently DOR had met with DNR to figure out a way to provide policymakers with a better production snapshot into the future; DNR had only played a small role in the forecast in the past. He stressed that DOR had done a good job with the forecast for the couple of years, but the longer-term forecast needed improvement.

[2:54:20 PM](#)

BRUCE TANGEMAN, DEPUTY COMMISSIONER, TAX DIVISION, DEPARTMENT OF REVENUE, provided a Power Point presentation titled "Oil Production Forecast." He planned to explain the production methodology that DOR had been working on for the past 18 months; the goal was a more prudent and reliable long-term forecast. He stated that oil funded over 90 percent of state government. He referenced committee member comments about the importance of planning for the future; the thoughts had been taken into consideration when DOR looked at its historically overoptimistic production forecast going back two decades. He emphasized that it was critical for legislators and the executive branch to have the best available information for short and long-term

budgeting. He read from AS 37.07.020, which designated that OMB:

...must set out significant assumptions used in the projection with sufficient detail to enable the legislature to rely on the fiscal plan in understanding, evaluating, and resolving issues of state budgeting.

Mr. Tangeman moved to a chart on slide 2 that compared overly optimistic production forecasts from 2002 through 2012. He pointed out that in year-one the forecast was fairly close to actual production, but none of the out years "were even close to reality". He reiterated Commissioner Butcher's earlier statement that projections were 40 to 60 percent off in the future. He pointed to bumps in the forecast that represented potential resources coming online, which had not necessarily come to fruition. He shared that DOR had a contract petroleum engineer consultant who had historically met with his counterparts at oil companies to discuss the next 10-year outlook. He furthered that a private sector budget person had been missing from the conversation. He relayed that William Barron the director of the Division of Oil and Gas for DNR had volunteered to help DOR work on the project. He was pleased at the current progress of the ongoing project.

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Mr. Tangeman moved to slide 4 and addressed concern that had been expressed by members of both the House and Senate Finance Committees. He read quotes from Representatives Mia Costello and Mike Doogan respectively: "Is it possible for the department to come forward with a plan for providing more accountability to the productions forecasts?" and "What I am asking is that I be given something that will give me more confidence that the projections that we see are, not necessarily 100 percent accurate, but that they have taken into account everything that they can, and we've got the best shot we can get."

Co-Chair Austerman acknowledged the presence of Representative Lora Reinbold.

WILLIAM BARRON, DIRECTOR, DIVISION OF OIL AND GAS, DEPARTMENT OF NATURAL RESOURCES, relayed that DOR had asked DNR to help establish a method to produce a reasonable out-

year production forecast for the greater North Slope region (factoring in several categories of production). He addressed efforts to understand the magnitude of the problem on slide 5 titled "Forecast Errors by Years in Advance Being Forecast." Numbers along the outside edge of a spider diagram represented years and data showed the percent error from forecast to actual. He noted that spider diagrams provided an insight into any patterns that may exist. He elaborated that the blue and red lines illustrated the errors from the 2001 and 2002 forecast to actual; the green line represented the average from 2001 to 2010. He pointed out that the pattern stayed the same; the error increased consistently as time went on.

Mr. Barron believed it was important for DOR and DNR to look at the issue independently from each other; if the departments both identified similar procedures it would help determine a better approach. He had asked DOR to establish confidence intervals based on all Alaska North Slope (ANS) production; DOR had used a standard deviation variance of all production from 1992 to 2011 and had projected it forward (slide 7). The bold green and light green dashes represented the upper and lower bounds of the production standard deviation forecast respectively. He added that it was necessary to factor in a multitude of items that could impact production. He pointed to a flattening of the curve beginning in 2006 through 2008; the leveling was predominantly due to the impact of gas cap water injection at Prudhoe Bay. He had asked DOR to look at the years prior to the enhanced oil recovery project and to identify the lower bound. Prior to 2006 the slope of the line was steeper than the slope across the entire "regime." The purple lines represented confidence intervals from 1992 to 2006. He elaborated that the lines established the high-high and low-low given the two different time parameters [1992 to 2011 and 1992 to 2006].

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Mr. Barron shared that the departments had considered three out of four tranches of the production forecast (slide 8): currently producing, under development, and under evaluation. He explained that currently producing or "old oil" applied to existing wells, facilities, and fields. "Under development" represented the first tranche of new oil; projects included in the category would be incremental to existing fields or new fields (projects that were

currently being funded). He furthered that under development projects had some risk; the confidence level fell in between currently producing fields and under evaluation fields. "Under evaluation" represented the second tranche of new oil. The category included projects that were likely to occur in the future; assessments had been made, but money had not been invested. Under evaluation fields had a greater risk than the first two tranches.

Mr. Barron relayed that "exploration" was the fourth tranche, which had not been included in the forecast. He elaborated that exploratory projects could be on the cusp of a company's lease sale or based on seismic information; the projects represented areas of new potential, but were not substantial enough to be included in the under evaluation category. He elaborated that shale oil was an example of exploration. He explained that shale by definition was a reasonable project; the current operator had drilled two wells on the North Slope, but no flow tests had been done. Core samples were currently being tested for "fracability" and product yield. He added that exploration could lead to projects, but there was no data available to project how it would impact the production profile from a budgetary perspective.

[3:09:14 PM](#)

Mr. Barron addressed the concept of risk on slide 9. He explained that risk was a natural component of the oil industry business. He read the last quote on slide 9:

The ability to convey the relative riskiness of various oil and gas projects in a consistent manner is an elusive and desirable goal.

[Source: Development and Implementation of an Integrated Risk Assessment Methodology. Cutten, Evoy, Grecu. SPE conference paper 1993]

Mr. Barron looked at risk assumptions on slide 10 titled "Accounting for the Risks Appropriately." Currently producing oil was not risked in the DOR forecast; some people had voiced that it should have been factored in given the lack of restart on some existing facilities the prior summer. He acknowledged the existence of uncertainties and unknowns even in the currently producing

category. The DOR consultant had done a ground-up assessment; every well was factored into the participating area and field-level review. He furthered that DNR had reviewed every field decline curve for reasonableness and credibility; staff had not agreed on everything, but it had agreed on the reasonableness and consistency.

Mr. Barron continued to discuss risk assumptions on slide 10. Risk related to new oil was factored into the forecast beginning with FY 15. He stated that the under evaluation portion of the forecast had a greater risk component than the under development category. He relayed that technical and non-technical risks had been included in the review. He communicated that many items impacted production forecasts (e.g. reserve assessment and other). The departments had looked at two categories: (1) budgetary control and (2) technical or production control; there were many subsets within the two categories. The main question was whether a project had come on in time and if it happened at the same rate as originally forecast; multiple items could have subtle impacts that were compounding.

Mr. Tangeman emphasized that currently producing fields were not included in the forecast risk assumptions; the category represented a very significant portion of the projected oil for the current and upcoming fiscal years. He clarified that the specific risk factor began in FY 15.

Mr. Barron moved to "Risk Factor 1: Delays" on slide 11. He relayed that delays (due to equipment not showing up on time or facilities were delayed) were likely to be a budgetary constraint. He pointed out that publications (e.g. Petroleum News and Oil and Gas Journal) were always accurate when they predicted a project would go online the following year; however, predictions became less accurate when a project was scheduled to come online further into the future. The only outlier was related to year 7 (shown in a chart on slide 11) when 7 years earlier when a company had accurately specified when it would bring the Northstar field on. He informed the committee that the numbers on slide 11 were relative, but it was important to account for delays or projections would be skewed. He reiterated that the closer a prediction was to the date it was scheduled to occur the more accurate it would be.

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Mr. Barron addressed "Risk Factor 2: Performance Deviates from Expectations" on slide 12. The slide showed production performances for oil fields including Badami, Aurora, Polaris, and Prudhoe Bay Satellites. He shared that the Badami field had been late coming online and production had peaked at 18,000 barrels per day (compared to the predicted production of 30,000 to 35,000 barrels per day). The Aurora field had been predicted to produce between 15,000 and 20,000 barrels per day, but it had peaked at 10,500. The Polaris field had peaked 30 to 40 percent lower than expected. However, Prudhoe Bay satellite fields had been predicted to bring in 40,000 barrels per day, but production had peaked at 50,000. He communicated that it was possible to have upside [deviation from expectations] as well as downside. He stressed that uncertainty existed as companies progressed a project from exploration to inception; a company's understanding of recovery factors and production increased once a project was producing and more information was obtained.

Mr. Barron directed attention to historical ANS production on slide 13 [identical to slide 7]. He explained that the high-high represented on the chart included all ANS production from 1992 to 2011; the lower edge represented a confidence interval based on 1992 to 2006.

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Mr. Barron pointed to slide 14 where DNR's refined method was applied. The red line represented industry production forecasting for currently producing, under evaluation, and under development fields without the risk factors; the line was not dissimilar from other forecasts and was flat followed by a slight positive increase and a decline. He believed it was important for the administration and departments to provide committee members with the high and low sides and a prediction proposal. The low side fell along the lower benchmark tranche and excluded the under evaluation and under development categories. The refined method including risk for under development and under evaluation and no risk for currently producing yielded the green curve on slide 14. He emphasized that the two programs had been done independently and were combined for review and assessment. The refined methodology fell slightly on the higher side of the spectrum's middle. He opined that the projection was reasonable; the goal had been to provide policy makers with a benchmark that

provided risk profile boundaries. Slide 15 showed a longer-term view of the refined model applied over time [1978 to 2022].

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Mr. Barron addressed that the real difference [between the original and refined methods] was how the departments looked at new oil. He pointed to a graph that illustrated the new oil share of total production on slide 16 [2012 through 2021]; the blue bar represented the 2011 forecast. The blue bars increased and then began to flatten out at approximately 40 percent to 45 percent of the total production. The red bars represented the 2012 forecast and were derived by using a risk model relative to under evaluation and under development tranches; out-year risk was factored in with projects that were not yet online.

Mr. Barron stressed that any good modeler would look back in history to determine how accurate the model would have been. He pointed to a spider diagram on slide 17 titled "Testing the Refined Method." The red line showed the original forecast error from 2001 to 2010. The blue line used the refined method and showed a significant reduction in overall error. He emphasized that the refined model took away approximately 50 percent of the error. He communicated that DNR had been asked to come up with a method that was more reasonable, more prudent, and more practical in terms of the out-year forecasting for the under development and under evaluation process.

Mr. Tangeman stated that the presentation and the DOR Revenue Sources Book were not meant to be "doom and gloom" scenarios. The goal had been to set a more realistic baseline for decision makers while recognizing the tremendous up-side of the state's resources. He stated that the forecast had historically dealt with what is possible compared to what is probable and had always been overly optimistic. He pointed out that chapter 4 of the Revenue Sources Book provided additional detail on the issue.

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Mr. Tangeman addressed potential concern about what ratings agencies would think of the state's process. He shared that Commissioner Butcher and Deputy Commissioner Rodell had met with the ratings agencies in late 2012 and had received

positive feedback on the department's process. He read a brief quote from the Standard and Poor's rating agency:

The state's Department of Revenue has a good track record forecasting year ahead prices and production levels. A bigger issue for the state is measuring the long-term rate of oil production decline. Since peaking in 1988 the average annual rate of decline in production has been around 5.5 percent; however, the state's long-term forecast has consistently projected a long-term rate of annual decline in oil production of just 2.5 percent or lower. As a result the state's long-term forecast has tended to overestimate actual production levels. With its fall 2012 forecast the Department of Revenue has revised the methodology used to develop its longer-term production forecasts. The new approach applies risk factors to discount the projected oil production from oil fields that are still under development or in the evaluation stage. Previously production estimates in the forecast from such fields were not adjusted downward to account for their higher level of uncertainty.

Mr. Tangeman elaborated that there were many items a rating agency took into account. Price and production were both very critical and DOR had received great feedback that it was headed in the right direction with its production forecasting.

Representative Guttenberg wondered whether an independent entity had been called upon to weigh in on the departments' approach to the forecasting method. He observed that during his time working for the legislature, price forecasters had admitted that they were always wrong. He recalled a legislative class that had been given in the past on mega projects; it had shown the ranges of projects that failed, succeeded, were over budget, and other. He believed the departments' work to increase forecasting accuracy was positive.

Mr. Barron replied that outside source had not been used; therefore, the confidence intervals had been established independently of the scenario plan. The Oil and Gas Division had reached out to some of its colleagues in the industry to ask if the approaches were reasonable; he relayed that the answer had been yes. He stated that the way assessment numbers had been generated could be

construed as arbitrary; therefore, DOR numbers were provided to identify where tranches lay. He furthered that the technique was not uncommon in the oil and gas industry; he had used a similar technique for long-term budgeting when he had worked for the industry. He acknowledged that forecasting was "a degree of wrongness" and the "best wrong answer we have today."

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Representative Guttenberg cited a disclaimer on slide 8 that stated "These definitions are not equivalent to those used by the Society of Petroleum Engineers (SPE) or Securities and Exchange Commission (SEC) and should not be used as such." He questioned how different the definitions were. He asked if another analysis had been done using the SPE and SEC definitions.

Mr. Barron responded that the terms "under development" and "under evaluation" were common industry terms, but they were not necessarily the same terms used by SPE or SEC. He stated that prevalent phrases used were "proven, probable, and potential." The definitions used in the analysis were not far off from those of the SEC and SPE. He elaborated that under the currently producing category there could be several sub-layers of SPE definitions; for the purpose of the analysis the basic definition was adequate. He added that the other two tranches fell within a probable and possible category, which would be similar to an SPE definition.

Representative Guttenberg remarked that the forecasting was now 30 percent wrong instead of 60 percent wrong.

Co-Chair Stoltze understood it was not possible to find someone to conduct a completely accurate price forecasting. He discussed risk and reward. He provided an approximate quote that the "U.S. tax code is the greatest influencer of behavior." He wondered about the influence of tax codes on production. He expressed the hope for further conversations with the departments throughout the legislative session.

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Mr. Tangeman replied that the exercise had been purely technical and had not taken tax, revenue, or other into

account. He deferred the question to Mr. Barron for further detail.

Mr. Barron agreed. He expounded that the model did not look at product price or fiscal regimes; the model used information and historical data related to fields on the North Slope and industry fields in general. He followed up on Representative Guttenberg's remark about mega projects and stated that 30 percent of projects were over budget and behind schedule 10 percent of the time; the reality needed to be included to produce a realistic model. The departments had not attempted to look at anything on a micro level. He discussed other parameters that had been factored in including the closer in time a project was due to come online there was less risk and higher certainty.

Representative Gara asked for verification that shale oil did not fall into any of the three tranches [currently producing, under development, and under evaluation]. He had heard from an industry person that ConocoPhillips had purchased leases around the Great Bear shale oil play.

Mr. Barron affirmed that shale oil did not fall under the three tranches (slide 8); it fell under the exploration category.

Representative Gara asked whether consideration should be given to shale oil. He acknowledged that shale oil could turn out to be nothing, but that it could also turn out to be a significant source of oil production on the North Slope.

Mr. Barron answered that the problem with shale was that there were no benchmarks showing its capacity or duration to date; there was "nothing to hang your hat on." He stressed that it would be "unbelievably speculative" to include anything like shale in a state forecast that would be used to make business decisions. He added that by the time shale was brought online it would fall under the high-high and low-low profile.

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Representative Gara asked if the revised forecast method was trying to be conservative or hit the middle line perfectly. Mr. Barron answered that the departments did not want to skew the forecast in either direction. The goal had

been to establish a method that would assess the relative risk related to time by the [under development and under evaluation] categories. The forecast could have been much more conservative or more optimistic, but the goal had been to use a technical and neutral methodology.

Representative Gara wondered whether ConocoPhillips had purchased leases near the shale area. He referred to Mr. Barron's statement that he had talked to industry as part of the analysis; he surmised there were members of industry who may overestimate production, others who may underestimate their production until oil reform occurred, and others who may be accurate; he wondered how the items were factored into the equation.

Mr. Barron replied that industry project engineers acted as salespeople when they pitched projects to senior management. He communicated that when the DOR consultant had met with industry engineers, a budget component had not been included in the discussion. The consultant had asked engineers what the production would be for different projects; the refined method had absorbed the data. He looked at the red line that showed a gross un-risked basis (slide 14); the line represented what had historically been presented in forecasts. He added that the red line was also overly optimistic. The refined methodology had looked at accuracy relative to time. He addressed what under development meant and used the Badami field as an example. The field had been a "huge" capital cost to BP when it had begun; it had under produced and hundreds of millions of dollars had been spent on the project. The occurrence was unfortunate, but the risk was inherent to the business.

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Mr. Barron addressed Representative Gara's question related to leases around shale oil plays. He stated that most of the leases around the south Great Bear play had been purchased by Royale Energy. He did not recall any major oil industry companies purchasing leases around shale oil plays. He would follow up with more detail.

ANGELA RODELL, DEPUTY COMMISSIONER, TREASURY DIVISION, DEPARTMENT OF REVENUE, provided a power point presentation titled "An Update on the State's Savings Accounts." She began on slide 3 related to general fund and other non-segregated investments; the fund was responsible for paying

state bills. The general fund had a moderate risk profile and tended to be invested in short to intermediate-term investments due to the high demand for liquidity. The fund had a balance of \$11.67 billion on December 31, 2012. The Statutory Budget Reserve (SBR) made up the largest portion of the general fund with a balance of \$5.487 billion on December 31, 2012; the amount was comprised of \$1.75 billion appropriated in FY 12, \$250 million appropriated in FY 13, and \$805 million in FY 12 surpluses. The other large piece of the fund was the Alaska Housing Finance Corporation (AHFC) and Alaska Housing Capital Corporation deposits of approximately \$1 billion. She relayed that to date the markets were much improved over the prior year. The improvement had been seen in the returns; the Year to Date (YTD) return was 1 percent compared to the Fiscal Year to Date (FYTD) return of 0.37 percent.

Ms. Rodell addressed the Constitutional Budget Reserve (CBR) main and sub funds on slide 4. The main fund had an intermediate, broad market, short-term asset allocation (a very conservative, moderate risk mix). The sub fund had a higher risk asset allocation and contained approximately 60 percent equities. On December 31, 2012 the balance was \$5.7 billion in the main fund and \$5.5 billion in the sub fund. She shared that the totals included the amounts paid by a BP settlement in December 2012; the CBR received a deposit of approximately \$160 million and the remainder went to the Permanent Fund and Public School Trust Fund. The YTD return was 1.9 percent for the main fund and 11.2 percent for the sub fund due to the robust equities market return in 2013.

Ms. Rodell directed attention to the Power Cost Equalization (PCE) Fund on slide 5. She explained that due to the fund's 7 percent target rate it had a higher risk tolerance and asset allocation. She was happy to report a YTD return of 7.38 percent. The balance was \$787.5 million on December 31, 2012.

Ms. Rodell spoke to the Public School Trust Fund on slide 6. She detailed that the fund's income was used for education formula funding. The principal fund was invested in a moderate risk profile made up primarily of broad market and equities (not to the same extent as the CBR). The principal fund had a balance of \$487 million and a 10.7 percent YTD return. The investment income was moved into the income fund for eventual appropriation to Department of

Education and Early Development; it had a balance of \$10.4 million on December 31, 2012.

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Ms. Rodell addressed the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) trust funds on slide 7. As of December 31, 2012 PERS had a balance of \$12.016 billion and the TRS balance was \$5.018 billion. She relayed that FY 12 had been challenging on the returns; the 0.52 percent return for PERS and 0.59 percent return for TRS was well below the 8 percent actuarial target rate. The FYTD returns were 5.63 percent and 5.68 percent for PERS and TRS respectively.

Ms. Rodell communicated that the Alaska Permanent Fund Corporation (APFC) had a December 31, 2012 balance of \$43.654 billion (slide 8). She noted that the number was up significantly from the prior year. The fund saw a low return of 0.02 percent for FY 12, but with the recovery of the equity markets the return had increased to 12.58 percent YTD and to 7.34 percent FYTD.

Ms. Rodell concluded with an FY 13 investment revenue forecast (slide 10); it was also included in the DOR Revenue Sources Book as part of the total revenue forecast. She noted that given current market conditions and low short-term rates a 0.6 percent return had been used in the forecast rather than a 2.87 percent (the expected interest earning over a 10-year period); the 0.6 percent return explained some of the declines in investment income expectation.

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Commissioner Butcher spoke to a question posed by Representative Gara at a prior meeting. He explained that the two CBR funds and the SBR fund totaled slightly under \$17 billion.

Co-Chair Austerman looked at slide 4 and surmised that the CBR main and sub funds could be subtracted from the total reserve fund to reach the SBR amount. Commissioner Butcher replied in the affirmative. He added that although the PERS, TRS, and APFC funds were flat for FY 12, they had been up approximately 20 percent for FY 11. He stated that the returns had been "pretty healthy" in the past two years

and were approximately 7 percent FYTD. The markets had been up and down, but targets had been exceeded over the past 2.5-plus years. He stated that although markets had recovered from the drop in 2008 and 2009, the numbers were still relatively low.

Co-Chair Austerman asked about the value of the SBR. Ms. Rodell replied that the SBR totaled \$5.487 billion on December 31, 2012.

Representative Munoz asked if the switch from a Defined Benefit to a Defined Contribution system had changed the department's projected rate of return for the retirement funds.

Ms. Rodell replied that Defined Contribution numbers were not included because individuals managed the asset allocation of their accounts. There were approximately 25 different investment options to select from.

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Representative Munoz understood, but wondered how the shift had impacted the projected rate of return. Ms. Rodell replied that the change did not have fiscal impact on the retirement fund accounts shown in the presentation.

Representative Gara asked for the current amount in the AHFC Capital Investment fund. Ms. Rodell replied that the account had contained approximately \$600 million at one point. She could provide an exact number at a later time.

Commissioner Butcher agreed. He added that the fund was available for appropriation for items like forward funding for education.

Representative Edgmon asked for a definition of the term Year to Date. Ms. Rodell replied that the current YTD was January 1, 2013 to the current day (calendar year to date).

Representative Edgmon surmised the state's fiscal year had to be factored into a fund's earning performance.

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Ms. Rodell replied in the affirmative and explained that Fiscal Year to Date was July 1, 2012 to the current day.

Representative Edgmon asked what 7 percent earnings on the \$17 billion in reserves would equal.

Commissioner Butcher replied that the 7 percent applied specifically to the PCE fund; returns were significantly lower on other state funds because approximately half of the general fund was invested very short-term and intermediate term due to liquidity issues for payments to the operating and capital budgets. The projected general fund return was approximately 3 percent. The PERS and TRS funds had an 8 percent target and APFC had a target of 5 percent plus inflation. The PCE fund was invested at a higher risk given its statutory target return of 7 percent.

Co-Chair Austerman thanked the departments for their presentations and discussed the schedule for the following day.

HB 65 was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

3:54:38 PM

The meeting was adjourned at 3:54 p.m.